MASTER
NEGATIVE
NO. 94-82266-2

Author:
Lisle, George

Title:
Account-keeping in principle and practice

Place:
Edinburgh

Date:
1911

94-82266-2

MASTER NEGATIVE #

COLUMBIA UNIVERSITY LIBRARIES
PRESERVATION DIVISION

BIBLIOGRAPHIC MICROFORM TARGET

ORIGINAL MATERIAL AS FILMED - EXISTING BIBLIOGRAPHIC RECORD

Lisle, George.

2 cop. Account-keeping in principle and practice, by George Lisle ... and W. A. Middleton ... Edinburgh and London, W. Green & sons, 1911.

2 p. l., vii–xv, 242 p. incl. forms. 22cm.

1. Accounting. 2. Bookkeeping. I. Middleton, W. A., joint author.

12—1503

RESTRICTIONS ON USE:

TECHNICAL MICROFORM DATA

FILM SIZE: 35mm REDUCTION RATIO: 12X IMAGE PLACEMENT: IA IIA IB IIB

DATE FILMED: 11-11-94 INITIALS: DSP

TRACKING # : MSH 03151

FILMED BY PRESERVATION RESOURCES, BETHLEHEM, PA.

2.0 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890

1.5 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890

PM-MGP 13"x18"
METRIC GENERAL PURPOSE TARGET
PHOTOGRAPHIC

150 mm

100 mm

A5

A4

1.0 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890

1.5 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890

2.0 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz
1234567890

2.5 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz
1234567890

PRECISION℠ RESOLUTION TARGETS

Century

A&P

1303 Geneva Avenue
St. Paul, MN 55119

4.5 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz
1234567890

3.5 mm ABCDEFGHIJKLMNOPQRSTUVWXYZ
abcdefghijklmnopqrstuvwxyz1234567890

ACCOUNT-KEEPING

IN

PRINCIPLE AND PRACTICE

PRINTED BY
WILLIAM GREEN AND SONS
EDINBURGH

ACCOUNT-KEEPING

IN

PRINCIPLE AND PRACTICE

BY

GEORGE LISLE,

CHARTERED ACCOUNTANT, FELLOW OF THE FACULTY OF ACTUARIES IN SCOTLAND; AUTHOR OF "ACCOUNTING IN THEORY AND PRACTICE," CHAMBERS' "ELEMENTARY BOOK-KEEPING," EDITOR OF THE "ENCYCLOPÆDIA OF ACCOUNTING," FORMERLY LECTURER ON "BOOK-KEEPING" AND "ACCOUNTING" AT THE HERIOT-WATT COLLEGE, AND ALSO LECTURER ON "BOOK-KEEPING" AT THE ROYAL BOTANIC GARDENS, EDINBURGH

AND

W. A. MIDDLETON,

CHARTERED ACCOUNTANT, LECTURER ON "ADVANCED BOOK-KEEPING" AND "PRINCIPLES OF ACCOUNTING" AT THE HERIOT-WATT COLLEGE, EDINBURGH

EDINBURGH AND LONDON
WILLIAM GREEN & SONS
PUBLISHERS
1911

PREFACE

THE authors in the course of the general practice of their profession, and also in their experience of the educational side of accounting, have found a tendency to rule-of-thumb methods in account-keeping, due in large measure to too exclusively teaching by example. While agreeing in general with this practical method of instruction, undue emphasis upon it leads to the study of the practice rather than the principles. This work has been prepared primarily to give a clear exposition of the principles of book-keeping in a readable form to enable the student to grasp the nature of the transactions and the reasons, accounting and legal, underlying the accepted methods of dealing with them. In view of the giant strides being made in these days in accounting and business organisation generally, there is a great need for holding firmly to established principles and sitting more loosely to hard-and-fast rules, and the following chapters are therefore insistent on the principles rather than on the methods of application. These methods must be so elastic as to vary with the particular requirements of every business, whether these variations be due to the nature of the business, its size, its constitution, or other general or special conditions under which it is conducted. It is believed that the work will contribute to the efficiency not only of accountancy students, but of business men generally and those who are handicapped by not having made a systematic study of book-keeping but yet find themselves faced with accounting problems in their daily work.

LISLE & MIDDLETON.

5 NORTH ST. DAVID STREET,
EDINBURGH.

CONTENTS

CONTENTS

ACCOUNT-KEEPING

I.—FIRST PRINCIPLES

Introductory.

THE science of account-keeping is a branch of knowledge which is of inestimable advantage to all who have financial relations with other parties. Such knowledge is never superfluous, but some to whom it would be of benefit are deterred from the study of the subject because of the predominance of the commercial element in the text-books. The reason for the invariable practice of drawing all illustrations from the world of commerce is that commerce is richest in examples of the application of the root principles of accounting, and it is not a knowledge of particular methods the student has any interest to acquire at first but of general principles. Given a thorough understanding of these principles, their application to undertakings of the most diverse character is a simple matter. We must apply ourselves then to the study of these principles, and afterwards consider certain of the innumerable variations in their application to business concerns of different kinds, of different sizes, or conducted under different conditions.

Objects of Book-Keeping.

Wherever commerce in its simplest elements is to be found, there also is the felt necessity for a record of the transactions. The primary motive which the trader has for engaging in business is the acquisition of wealth, and he therefore desires to know from time to time his financial position. This is the first plea for the keeping of business records, however rudimentary. With the extension of credit there has arisen an increased necessity for strict accounting, for the trader has the wholesale houses as his creditors on the one hand, and his customers as his debtors on the other,

and with both of these classes an accurate reckoning is essential to confidence. This is a second plea for the keeping of business records. Having realised the need for some form of accounts, the trader must then choose between a complete system showing him his financial relations with outsiders and his revenues and expenditure suitably classified for his future guidance, combined with some form of check which would inspire him with a confidence in its accuracy—that on the one hand, and on the other a group of accounts showing his dealings with his debtors and creditors but telling him nothing of the internal economy of the business. His choice, in other words, lies between what are known as the Double Entry and Single Entry systems. A business man wants his books to give him two important classes of information :—

(1) What is his financial position at any given time.
(2) What are the particulars of income and expenditure which have effected the change on his position since last he reviewed it.

Single entry books enable him to answer only the former of these two queries partially, but double entry books enable him to answer both fully. Double entry, then, is the system to engage the attention of the student in the first place, and single entry can be afterwards studied as a detached and incomplete part of the double entry system.

Double Entry.

The double entry system of book-keeping may be defined as "that system by which the double effect of each transaction is recorded, thereby giving both a debit and a credit entry for every transaction." Every transaction in business has a twofold effect, and for the recording of that twofold effect a twofold or double entry is required. It is clear then that double entry is constructed upon a scientific basis, and it is so adaptable to business requirements and capable of so great specialisation that it is found to fulfil all the demands of present-day business life. The very essence of this principle of debit and credit is found in the Ledger, and, as the Ledger is the ultimate destination of all the entries recorded, although they may be first set down elsewhere for convenience, we shall examine it first.

The Ledger.

The Ledger may be defined as "the book in which the entries of a series of business transactions are classified according to their nature by means of separate accounts which distinguish between debits and credits."

The following is a specimen of the common Ledger ruling. The headings are explanatory only, and do not usually appear in the Ledger.

Dr. NAME OF ACCOUNT. *Cr.*

Date	Item	Folio	Amount	Date	Item	Folio	Amount

Ledger Accounts Classified.

It will be seen that the ruling consists of two uniform sections (left and right), each section being complete in itself with the columns necessary for the recording of the entries. The one section is the debit or debtor (Dr.) side, the other the credit or creditor (Cr.) side of the account. The Ledger is ruled throughout according to the foregoing pattern, and on the separate pages at convenient intervals the names of the accounts are written at the top. This process is spoken of as "raising the Ledger headings." We shall find that the Ledger Accounts required by every kind of business can be divided into three distinct classes. The first of these embraces all the accounts of our business relations with persons, firms, and companies and other corporate bodies; these are termed PERSONAL ACCOUNTS. The second class embraces those records we have kept of the goods and properties we have acquired or dealt in, such as goods (merchandise), shop furnishings, heritable properties, investments, plant, cash, or other kind of property; such accounts are termed REAL or PROPERTY ACCOUNTS. The third class embraces those accounts which we have kept relating to our income from different sources and our expenditure under the various heads, the former division including profit from goods, discounts allowed to us, dividends from investments, interests

receivable, and such like items, and the expenditure accounts including wages, rent and taxes, carriage of goods, &c.; these are termed PROFIT AND LOSS ACCOUNTS or NOMINAL ACCOUNTS, the latter term being preferred for the sake of distinction from the general Profit and Loss Account. In the Ledger, then, we have all our entries classified into separate accounts, and every one of these accounts is Personal, Real, or Nominal.

Having divided the Ledger Accounts into three groups, we must next endeavour to formulate some simple rules to guide us in making the entries in these accounts, as the transactions may fall one ither the Dr. or Cr. side. It is very important to notice that any transaction must be considered from the point of view of the account in which the entry is to be made.

TO DEBIT AND CREDIT ACCOUNTS.

Personal Accounts.

If we give A a loan of a sum of money or sell him goods, he manifestly becomes our debtor for the item. Were we to record such a transaction in A's account in our Ledger we must make A our debtor, that is, we enter the item on the Dr. side of A's account. We can from this illustration deduce the rule—Debit a Personal Account when the person receives.

If we receive goods from B he becomes our creditor in the transaction. We must, therefore, in B's account in our Ledger record B as our creditor, that is, we enter the item on the Cr. side of B's account. From this illustration we have the converse of the previous deduction—Credit a Personal Account when the person gives.

In writing up Personal Accounts, then, we have as a rule admitting of no exception—*Debit the account of a person when he receives, and credit his account when he gives.*

Real Accounts.

It is an easy matter to understand a person debtor for what he receives and creditor for what he gives, but to conceive of some form of property being regarded as debtor and creditor is a novel idea. Yet so it is; in writing up our Real or Property Accounts we retain the principle of debtor and creditor. When we receive cash we must show that transaction in our Cash Account. Now if we look upon our till or cash-box as invested with a personality who is to be responsible for all cash put in we would find that the rule we applied to Personal Accounts would hold good here, that is, the till or cash-box becomes debtor for all that is put into it (all it receives) and creditor for all that is taken out of it (all it gives). In other words, all cash received is entered on the Dr. side of the Cash Account, and all cash paid away on the Cr. side. The same idea can be applied to the merchandise coming into the warehouse, the Goods Account being Dr. for what comes into possession and Cr. for what goes out of possession. The rule we deduce from these illustrations, stated shortly, is—*Debit a Real Account when the property comes into possession, and credit it when it goes out of possession.*

Profit and Loss Accounts.

Still less is it easy to conceive of Nominal Accounts, which treat of sources of income and heads of expenditure, as debtors and creditors, but even here we retain that principle. When we pay wages the two accounts involved in the transaction are Cash and Wages. The Cash is paid away—goes out of possession—and Cash Account is therefore to be credited with the item, in conformity with our last rule, and the Wages Account is debtor to Cash for the payment. Similarly, if cash be received for interest on an investment, the Cash Account must be debited as cash comes into possession, and the other account concerned, namely, Interest Account, must be made creditor by that cash. The rule which we evolve from such illustration is—*Debit a Nominal Account when the item is a loss or expenditure, and credit it when the item is a gain or income.*

These three essential rules for the treatment of all transactions, must be thoroughly grasped before further progress is attempted, and for committing to memory they may be summarised thus:—

PERSONAL ACCOUNTS—DEBIT RECEIVERS, CREDIT GIVERS.
REAL ACCOUNTS—DEBIT WHAT COMES IN, CREDIT WHAT GOES OUT, OR—DEBIT ACQUISITIONS, CREDIT DISPOSALS.
NOMINAL ACCOUNTS—DEBIT LOSSES, CREDIT GAINS.

The destination of every entry is capable of ascertainment by one of these tests.

Examples of Accounts.

We shall now examine in detail an example of each of the three classes of Ledger Accounts, taking first a Personal Account.

Personal Accounts.

A B.

Dr.								*Cr.*
July 1. To Goods .	£12	6	7	Sept. 10. By Cash .	£10	0	0
Oct. 15. „ „ .	11	8	6	Dec. 31. „ Balance	13	15	1
	£23	15	1		£23	15	1
Jan. 1. To Balance .	£13	15	1				

The foregoing is an illustration of how the account of a fictitious customer, A B, might appear in our Ledger, covering the half year from 1st July to 31st December. On 1st July we sold goods to A B; he was *receiver*, therefore debtor. Every Dr. entry is preceded by "To," and the entry then reads, "A B debtor to Goods." Similarly with his other purchase on 15th October. On 10th September he paid us cash towards his indebtedness; he was *giver*, therefore creditor. Every Cr. entry is preceded by "By," and the entry thus reads, "A B creditor by Cash." At 31st December, when we are to balance our books, we find the account show, Dr. £23, 15s. 1d. and Cr. £10. To balance the account we insert on the smaller side (the Cr. in this example) the amount required to make it up to the greater, and the amount so entered is then carried to the opposite side under the opening date of the new financial period. In the above illustration the difference between the Dr. and Cr. sides is first credited on 31st December, and thereafter it is debited in the *new account*, as it is termed, under date 1st January of the new year, the *narration* being "Balance" in each case. It should be noticed that the effect of crediting the balance on the account and then carrying it down to the opposite side is the same as if the Cr. total had been deducted from the Dr. and the excess of debits left standing on the account. The balance of £13, 15s. 1d. standing on A B's account would be spoken of as "a Debit Balance," and shows A B debtor for that amount.

The foregoing is an example of a debtors' (say a customers') account. In the case of a creditors' account the position would be reversed, thus:—

C. D.

Dr.								*Cr.*
Sept. 12. To Cash .	£24	0	0	Aug. 12. By Goods .	£24	15	6
Dec. 31. „ Balance	9	6	9	Nov. 11. „ „ .	8	11	3
	£33	6	9		£33	6	9
				Jan. 1. By Balance	£9	6	9

C D has been credited with the goods we purchased from him, as he was *giver*, and he was debited with the cash we paid him, as he was *receiver*. The balance is first entered on the smaller side, then carried down below to the opposite side, and is spoken of as "a Credit Balance."

The most familiar instance of a Real Account is the Cash Account, in which are entered all cash transactions, both receipts and payments. For the month of July the account might appear like the following:—

Real Accounts.

Cash Account.

Dr.								*Cr.*
July 1. To Balance .	£10	0	0	July 3. By R S .	£2	10	0
„ 3. „ A B .	5	10	0	„ 5. „ Bank .	30	0	0
„ 5. „ Goods .	25	0	0	„ 10. „ Wages .	10	0	0
„ 10. „ C D .	14	12	6	„ 20. „ E F .	15	10	3
„ 15. „ Goods .	9	5	3	„ 23. „ Bank .	10	0	0
„ 22. „ „ .	5	13	9	„ 31. „ Balance	9	11	3
„ 31. „ „ .	7	10	0				
	£77	11	6		£77	11	6
Aug. 1. To Balance .	£9	11	3				

The cash received during the month is debited—we debit *what comes into possession* in Real Accounts—and the narrative of the entry shows us whether the receipt has been in settlement of a customer's account or for cash sales of goods. The payments are credited—we credit *what goes out of possession* in Real Accounts—and the narrative shows us the nature of the payment. The two sides are cast up and the difference

entered on the smaller side and carried down to the opposite side, as in balancing Personal Accounts. The debit balance shown in the foregoing illustration at 1st July, was the cash on hand at that date, which was brought down from the June account in the same way as the £9, 11s. 3d. is shown carried down to the August account. It will suggest itself to the student that the balance on the Cash Account at any time is the amount of cash in hand at that date, and as the cash paid away can never exceed the amount received, so there can never be a credit balance on the Cash Account.

Profit and Loss Accounts.

The Nominal Accounts merely contain records of profits and losses, these being classified under convenient heads suitable to the particular business. The following example will serve to illustrate the form of Nominal Account, although, as will be seen later, other considerations would require to be dealt with in the Rent Account in actual business:—

Rent Account.

Dr.			*Cr.*	
May 15. To Cash .	£36 0 0	Dec. 31. By Profit and Loss Account	£72 0 0
Nov. 11. „ „ .	36 0 0		
	£72 0 0		£72 0 0

This Rent Account is debited on 15th May and 11th November (the usual half-yearly terms in Scotland) with the cash paid in respect of rent, the rule being—debit *losses*, and such payments by us were obviously losses, expenditures. When we are balancing our books at 31st December for the year, we transfer the amount of the Rent Account to a general account which we term the Profit and Loss Account. Our sole purpose in keeping separate Nominal Accounts is to group our profits and losses under sub-heads, and when our financial year has closed we transfer the income and expenditure in these subsidiary Profit and Loss Accounts into one account of that name, so as to arrive at the aggregate result. Accordingly, the foregoing example of Rent Account is closed at 31st December by being credited with the amount necessary

to make the two sides equal, and the Rent Account for the new year would begin underneath with no balance or opening items such as occurred in our previous examples.

THE GOODS ACCOUNT.

Gross Profit.

A commercial man looks to the sale of his goods to yield him his profit, and it is from the Goods Account that he would seek to ascertain the return from his dealings in his merchandise. The profit on goods is the margin by which the selling price exceeds the cost price of the goods, and this profit is termed *Gross Profit.* It is the profit on the turnover of the goods without deduction of the expenses incurred in the carrying on of the business.

Stock-Taking.

It is clear that if we buy goods for £100, and, after selling a portion of them for £80, we find that the quantity remaining cost us £30, our profit on the deal up to date is £10. This simple series of transactions may be set out in the form of a Goods or Trading Account, thus:—

Goods Account.

Dr.			*Cr.*	
To Goods purchased	£100 0 0		By Sales . . .	£80 0 0
Deduct—Stock on hand at closing date .		30 0 0		
Leaving, as cost of the portion sold .		70 0 0		
„ Gross Profit .		10 0 0		
		£80 0 0		£80 0 0

The goods purchased are debited to Goods Account as the goods *came into possession,* and the goods sold are credited because they *went out of possession.* The whole goods purchased by us cost £100, and after effecting the sale of a quantity we must value the remainder at cost price. In the foregoing example this remainder, which is termed the "stock on hand," is deducted from the total cost so as to bring out by

mathematical reasoning the cost of the portion sold; but in book-keeping deductions like this are seldom made, as the same effect can be got by making the entry on the opposite side of the account. The above account would then appear thus:—

To Purchases .	£100 0 0	By Sales . .	£80 0 0
„ Gross Profit .	10 0 0	„ Stock on hand .	30 0 0
	£110 0 0		£110 0 0
To Stock on hand .	£30 0 0		

The stock on hand is credited here instead of being deducted from the Dr. side, and it is then carried down to the opposite side. The reason for this is that the new period's account becomes Dr. for this value of goods which *come in* to it; in fact, the old period's Goods Account may be regarded as giving away the goods to the new period's account, for which the rule is, Credit what goes out (*i.e.* the old account is to be credited) and debit what comes in (*i.e.* the new account is to be debited).

It will be remembered that when dealing with an example of the Cash Account we found that the balance on the account always represented the actual cash in hand. This is not so in the case of the Goods Account, as the cost price, which is on the Dr. side, differs from the selling price, which is on the Cr. side. The value of the stock on hand at any time cannot be found from the Goods Account; the goods themselves must be inventoried, weighed, or measured, and the different items priced out at cost. The only circumstances under which any other price than cost may be adopted at stock-taking are (1) when the market price of the goods has fallen below the cost price of the goods we have on hand, and (2) when the goods have deteriorated and will require to be sold at a sacrifice. In the former case we may adopt the market price so as to err on the safe side, but if the fall in market price is but temporary, we would be justified in adopting the cost price in our valuation. In the pricing of deteriorated goods allowance must be made for their depreciation, and they should accord-

Valuation of Stock.

ingly be valued only at what they might be bought for in open market. In all such questions admitting the exercise of discretion the error should always tend towards the more unfavourable view.

The other entry in the example is "Gross Profit." This is the gain on the sale of the portion of the goods dealt in, and this profit is now transferred to the general account into which are gathered the profits and losses under the various heads, that is, the entry recorded here might have been worded, "To Profit and Loss Account," as the gross profit is transferred to the Cr. of that account.

The Goods Account in ordinary circumstances would be of a slightly more complex nature than the foregoing illustration, as, in a business which has been carried on for more than the current trading period, there would be the stock on hand at the opening of the account to be dealt with. The following example will illustrate the usual features of the Goods Account:—

Opening and Closing Stocks.

Goods Account.

Dr.				*Cr.*
July 1.	To Stock on hand . £364 10 0		Dec. 31.	By Sales during half-year . £2575 10 9
Dec. 31.	„ Purchases during half-year 1635 10 0			„ Stock on hand . 424 9 3
	„ Gross Profit . 1000 0 0			
	£3000 0 0			£3000 0 0
Jan. 1.	To Stock on hand . £424 9 3			

This account is Dr. for the stock *coming in* to it at 1st July from the previous account, and it is also Dr. for the Purchases made (goods *coming in*) during the half-year. The account is Cr. for the price charged for the goods *gone out* during the half-year, that is, the Sales, and it is also Cr. for the stock on hand which at 31st December is being handed over to the new period—the goods *go out* of

one half-year and *come in* to the other. The Cr. side of the account is greater than the Dr., and this difference is the gross profit earned on the goods sold. The stock on hand at 31st December is priced out at £424, 9s. 3d. This in ordinary cases is its cost price, the price at which it is included among the old stock or the half-year's purchases. The same result as to gross profit can therefore be arrived at by the more logical statement of the account thus:—

Cost against Returns.

Goods Account.

Dr.						*Cr.*			
July 1.	To Stock at this date	£364	10	0	Dec. 31.	By Sales .	£2575	10	9
Dec. 31.	" Purchases for half-year .	1635	10	0					
		£2000	0	0					
	Less— Stock at this date	424	9	3					
	Cost of Goods .	£1575	10	9					
	" Gross Profit .	1000	0	0					
		£2575	10	9			£2575	10	9
Jan. 1.	To Stock on hand brought down .	£424	9	3					

This form shows clearly that the total cost of the goods dealt in during the half-year was £2000, and of this total cost there remained unsold at the close of the period goods valued at £424, 9s. 3d. This figure being deducted from the £2000 gives £1575, 10s. 9d. as the cost of the goods which have been sold, and as they were sold for £2575, 10s. 9d., a gross profit of £1000 was realised. This form of Goods Account is frequently referred to as the "cost against returns" style, "returns" here meaning the gross returns on sales, *i.e.* selling price.

The Profit and Loss Account.

The Profit and Loss Account may be defined as "an account showing on the one side all the gains and on the other the expenditure over a period of trading." This account does not give the items of income and outlay in detail, but merely shows the net gain or loss under each head, as brought out in the subsidiary accounts which we have come to term Nominal Accounts, and which, as has already been explained, are for grouping under convenient heads the income and expenditure of a business. Periodically the trader desires to know his position and also to see the items of profit and loss which have contributed to the change in his position since last stock-taking. It is therefore necessary to transfer the different profits and losses as shown on the separate Nominal Accounts to some general account, in order that the aggregate result of the period's trading may be shown. The Profit and Loss Account is opened for this purpose, and the Gross Profit from Goods Account already dealt with is carried to the Cr. side of this Profit and Loss Account, and also all other gains shown on the different Nominal Accounts. Then the items representing expenditure must be transferred from the other Nominal Accounts, such as Wages, Rent, Carriage, Customers' Discounts, etc., to the Dr. of the Profit and Loss Account. It will be noticed that the Profit and Loss Account conforms to the rule applicable to the subsidiary Nominal Accounts — Debit losses, credit gains. Having gathered into this account all the profits on the Cr. side and all the expenditure on the Dr. side, then, if the Cr. be the greater, the amount of the difference is the Net Profit, but if the Dr. exceed the Cr., the difference is the loss on the period's trading. The following example shows the usual features of a Profit and Loss Account for a commercial house; frequently the terms Expenditure and Income are used instead of Dr. and Cr.:—

Profit and Loss Account.

Dr.				*Cr.*			
To Rent and Taxes .	£126	10	0	By Gross Profit from Goods Account .	£1000	0	0
„ Wages and Salaries	473	12	6	„ Discounts from wholesale houses	98	17	6
„ General Charges .	210	4	0	„ Dividends from investments .	43	4	5
„ Carriages . .	15	4	9				
„ Bad Debts and Discounts . .	50	2	8				
	£875	13	11				
„ Net Profit . .	266	8	0				
	£1142	1	11		£1142	1	11

Net Profit.

The foregoing account shows three sources of profit in this particular business and the amount accruing from each during the trading period under review, and it also shows under separate heads the expenditure which has to be met out of the gross profits before the actual or net profit remains to the trader. This Net Profit is entered on the Dr. side of the Profit and Loss Account to make up that side to the sum of the Cr. side; it represents the amount by which the profits exceed the expenditure. This Net Profit is the remuneration of the trader for his abilities, the use of his capital, and the risk of loss which he accepts in engaging in business; and the Net Profit found to have been earned must therefore be passed to his own account with the business, which is termed the "Capital Account."

The Capital Account.

When the books of a business are kept on the double entry system, even the trader to whom the concern belongs is regarded as an outsider and has an account opened for him in the business ledger to show his dealings with the business. In other words, the business is reckoned as possessing an identity of its own, and when the trader gives any money or valuable consideration to the business he is credited (as *giver*) as if the business had to account to him for it; and likewise when he withdraws any money or takes any goods from the business he is debited (as *receiver*). The trader's account does not usually bear his name, being ordinarily distinguished by the designation "Capital Account." One essential point of difference between the Capital Account and any other Personal Account is that the balance of the Profit and Loss Account, representing the Net Profit or Loss on the period's trading, is transferred to Capital Account. The trader's motive for conducting the business is to earn profit, and all profit therefore falls to be credited to him as accruing from the exercise of his business abilities and the use of his capital; and conversely, if the period's trading results in a loss, the amount falls to be debited to him, that is, the Capital Account is credited with Net Profit or debited with the loss brought out in the Profit and Loss Account of the business. The following illustration gives the usual points in a trader's Capital Account:—

Capital Account.

Dr.				*Cr.*			
Dec. 31. To Drawings during half-year	£121	6	8	July 1. By Balance .	£1000	0	0
„ Balance .	1145	1	4	Dec. 31. „ Net Profit for half-year	266	8	0
	£1266	8	0		£1266	8	0
				Jan. 1. By Balance .	£1145	1	4

Drawings Account.

The item debited above as "Drawings during half-year" is the total of a subsidiary account kept of all the sums of cash and goods taken by the trader during the period, such account usually bearing the name "Drawings Account." The total of this subsidiary account is transferred to Capital Account at the close of each financial period. The Net Profit credited above is the balance of profit as brought out in the Profit and Loss Account, and represents the amount by which the trader's capital is increased by the half-year's net earnings. The balance credited at 1st July was the capital for which the trader was at that date the creditor of the business; it was carried down thence from the previous period's Capital Account in the same way as the new balance of capital is shown credited at 1st January to open the new period's Capital Account.

The Balance Sheet.

The various Ledger Accounts which we have discussed all bear their own part in the record of a period's business transactions, and each supplies its own particular item of information, but when the trader desires to know his financial position it is necessary that he bring together all that relates to his debts and his funds available for their payment and set it out in such a form as would show him how he stands. The Balance Sheet is such a statement. It may be defined as "a statement showing on the one side all the assets and on the other all the liabilities of a business at a particular date." Now it is to be noted that the Balance Sheet is not an account with a Dr. and a Cr. side; it is merely a statement—two parallel lists, the one of assets, the other of liabilities, prepared from double entry books at a particular date. It will be recollected that in treating of the Profit and Loss Account we found that the items appearing in it were the income and expenditure over the period, that is, the account itself was a summary of the Nominal Accounts, in which were grouped the details composing the gains and losses. The Balance Sheet is totally different from this; it may be accurately described as a photograph of the financial position of a business. A photograph of any subject shows how it appeared at some particular time; so with the Balance Sheet. The whole assets and liabilities of the business must be taken down as they stood at a particular date, consequently the Balance Sheet is only correctly spoken of as "as at" a specified date, not as "for the year." Then, as the Balance Sheet is not an account, the terms Dr. and Cr. are not used and the complementary "To" and "By" are also dispensed with. Some prefer to regard a Balance Sheet as "the account of the business," showing the business debtor for its liabilities and creditor for its assets, and it is doubtless on this view that the model form of Balance Sheet for Joint Stock Companies, as given in the Schedule to the Companies Act of 1862, was framed. Dr. and Cr. commonly appear on such Balance Sheets. This model form of Balance Sheet is not prescribed in the Revised Table A

issued in 1906, but its features will doubtless be retained by those concerns which had previously followed it.

Liabilities are all those sums for which the business can be held liable, that is, all debts payable by the business whether presently due or not. Assets are all funds and properties of whatever description, everything having a money value to the business. The following example of a trader's Balance Sheet will illustrate these points:—

Balance Sheet as at 31st December.

Liabilities.				*Assets.*			
Creditors' Accounts .	£291	7	6	Customers' Accounts .	£795	8	4
Capital . . .	1145	1	4	Stock on hand . .	424	9	3
				Plant and Fittings .	116	11	8
				Cash at Bank . .	95	6	4
				Cash on hand . .	4	13	3
	£1436	8	10		£1436	8	10

Assets.

We shall treat the items singly, taking the assets first. At 31st December our customers in many instances had not settled their accounts, so in our Ledger we find many items standing on these Personal Accounts. The accounts are balanced as previously explained, the balances being carried down to the Dr. side, the customers being our debtors for what they owe us. A list of these balances is made out to avoid enumerating all the accounts in our Balance Sheet, and the total of the list is inserted as an asset under "Customers' Accounts," as shown. In discussing the Goods Account the process of valuing the stock on hand—*i.e.* stock-taking—was explained, and the value as ascertained was credited to the Goods Account for the old financial period and carried down to the Dr. of the Goods Account for the new financial period. In drawing up our Balance Sheet, then, we insert this stock on hand, as shown in our Goods Account, among our assets; it is a kind of property the business was possessed of at 31st December. The Plant and Fittings Account in our Ledger is another Real Account, and the balance standing on its Dr. side at 31st December was the value we placed upon

the item at that date, and therefore it too must be stated as an asset, something having a money value to the business. From time to time during our trading we have paid money into a Bank Account — our bankers were *receivers* and we accordingly debited them with the sums paid in; and from time to time we have drawn out money from this Bank Account—our bankers were *givers* and we accordingly credited them with these withdrawals. But we paid in more than we have withdrawn, so at 31st December we had still in that Bank Account £95, 6s. 4d.; our bankers were our debtors to that extent. That Bank balance was an asset of the business at that date, and is therefore included in the Balance Sheet as such. We have already gone fully into the keeping of the Cash Account, and it is now only necessary to remind the student that the cash on hand at any date should agree with the Dr. balance on the Cash Account. Cash on hand is obviously also an asset.

Liabilities.

Now the liabilities. We had not, before the closing of our books, settled all the debts due by us to 31st December, and the various creditors to whom we were indebted had Cr. balances standing on their separate Ledger accounts. A list of these Cr. balances on the Personal Accounts is made up, as in the case of the customers, and its total inserted in the Balance Sheet under "Creditors' Accounts," as shown. The Capital Account has already received separate treatment, and it will be remembered that the trader himself is to be regarded as an outsider and a creditor of the business. The trader's own account with the business is the Capital Account, and when the concern is solvent this account always has a Cr. balance on it, that is, the trader is a creditor of the business for the amount of capital he has in it. The item of capital appearing among the liabilities in the foregoing Balance Sheet is the amount which at 31st December stood at the Cr. of the Capital Account in the books. Capital is the amount owing by the business to the trader personally; the Balance Sheet is the Balance Sheet of the business; the capital must therefore be included in the Balance Sheet as a liability.

Capital.

It will be noticed that the different assets and liabilities have all been described as balances appearing on some Ledger account, and still the total of the assets agrees with the total of the liabilities. This is a feature of double entry book-keeping, and is a consequence of the strict application of the principle of making both a Dr. and a Cr. entry for every transaction. The assets stand as Dr. balances and the liabilities as Cr. balances on their respective Ledger accounts. Theoretically the assets, being Dr. balances, should stand on the left-hand side of the Balance Sheet, and the liabilities, being Cr. balances, should appear on the right-hand side, but the practice of accountants differs on this point. The form given above, showing the position reversed, appears to have gained most support, principally, no doubt, following the Companies Act model form already referred to. So long as the respective sides are clearly designated as assets and liabilities the position is of little practical importance.

The Double Entry.

Transactions.

Having examined the general rules governing the different Ledger accounts, we must now consider the treatment of transactions. We must throughout bear in mind that without a single exception transactions must be given a twofold effect in our books; there must be both a Dr. and a Cr. entry for every transaction. The first thing to decide with any given item is which Ledger accounts it affects, and the second point is which is Dr. and which Cr. A few examples of the commonest transactions will help the student to understand the method of dissection of the items, thus:—

We sell goods to A B on credit.

A B was *receiver* in the transaction, we debit receivers, ∴ A B Dr.

The goods *went out of our possession*, we credit to Real Accounts what goes out, ∴ Goods Account Cr.

We sell goods for cash.

What happens here is, we get cash in exchange for goods. Cash *comes in*, ∴ Cash Account Dr. Goods *go out*, ∴ Goods Account Cr.

We buy goods from C D on credit.

Here we get goods, goods *come in*, .·. Goods Account Dr.
C D gives us these goods, C D is a *giver*, .·. C D Cr.

We buy goods for cash.

We get goods and give cash.
Goods *come in*, .·. Goods Account Dr.
Cash *goes out*, .·. Cash Account Cr.

We receive cash from A B.

Cash *comes in*, .·. Cash Account Dr.
A B *gives* that cash, .·. A B Cr.

We pay wages in cash.

This is an *expenditure* or *loss* under "Wages," and cash *goes out.*
We debit *losses*, .·. Wages Account Dr.
Cash *goes out*, .·. Cash Account Cr.

When a trader begins business he commonly puts in a sum in cash.

Here we have cash *coming into the business*, .·. Cash Account Dr.
And the trader is the *giver*, his account is the Capital Account, .·. Capital Account Cr.

These few simple examples serve to illustrate the way of ascertaining the destination of the entries in double entry books, and it will be seen that *the first requisite to the proper solution of the queries is a full understanding of what actually happened in the transaction*, and *the second, a thorough familiarity with the three rules laid down for the debiting and crediting of the three classes of Ledger Accounts.*

"Cross Entries."

In addition to passing through our books entries of business transactions we have occasionally to make entries transferring an item or total from one account to another. For example, as already explained, the gross profit earned on the turnover of our goods has to be debited in Goods Account to make the Dr. side of that account

equal to the Cr.; the Cr. entry for the gross profit so debited is to be made in Profit and Loss Account, on the Cr. side of which, it will be remembered, are gathered all the profits arising from the different sources.

The Nominal Accounts kept for the different heads of expenditure are closed at the end of each financial period by being credited with the sum necessary to square them, the Profit and Loss Account being debited with the same sum for the expenditure under that head for the period, *e.g.* our Wages Account shows total debits of £160 for the half-year just closed. To square the account a Cr. entry, "By Profit and Loss Account, £160," is made, and the corresponding Dr. entry is made in Profit and Loss Account thus, "To Wages, £160."

The net profit ascertained in the Profit and Loss Account is debited there either as "Net Profit" or "To Capital Account," and the corresponding Cr. entry is made in Capital Account as either "By Profit and Loss Account" or "By Net Profit." All these entries are merely transfers from one Ledger account to another, or "cross entries," as they are termed, and the equality of debits and credits is as strictly maintained as in the recording of actual trade dealings. These cross entries are required usually in closing the books for a financial period—when we term them "closing entries"—and to adjust errors of posting.

The Trial Balance.

Proving the Books.

It is now clear to the student that as every transaction and cross entry has a Dr. entry in one account and a Cr. entry in another, the total debits in a set of books must equal the total credits at any time. When, therefore, it is desired to test the accuracy of the books, either before closing them at the end of the financial year or at any other date, the method employed is to make out a list of the Dr. and Cr. balances standing on the various accounts at that date. This list of balances taken off for such a purpose is called a "Trial Balance." The following example will convey the idea of its form:—

Trial Balance as at 31st December.

A B	£795 8 4	
C D		£291 7 6
Goods	2000 0 0	2575 10 9
Plant and Fittings	116 11 8	
Bank	95 6 4	
Cash	4 13 3	
Capital	121 6 8	1000 0 0
Dividends from Investments		43 4 5
Wages and Salaries	473 12 6	
Rent and Taxes	126 10 0	
Carriages	15 4 9	
General Charges	210 4 0	
Bad Debts and Discounts	50 2 8	
Creditors' Discounts		98 17 6
	£4009 0 2	£4009 0 2

It should be noted that the Trial Balance shows how the accounts stood *at a particular date*—it does not *cover a period.*

Two Forms. The amounts are arranged as debits and credits, all Dr. items being taken down into the Dr. column, and Cr. items into the Cr. column. The form of the Trial Balance may vary with its purpose. When it is prepared merely to test the accuracy of the books, the *total* debits and credits of all the accounts in the Ledger are usually taken down into the Trial Balance; but when it is prepared just prior to closing off the accounts for the financial year, it commonly is prepared in the foregoing style, in which, it will be observed, only the *difference between* the debits and credits is taken down in all accounts except Goods and Capital. The reason for making exceptions of these two accounts is that the total of each side has an important significance; the Dr. of the Goods Accounts represents the value of goods which have *come in* during the period, and the Cr. represents the total sales for the period. In the Capital Account the Cr. gives us the capital held in the business by the trader, and the Dr. side gives his withdrawals from the business during the financial period.

Banking Transactions.

One of the most frequent transactions found in a series of business dealings is some operation on the Bank Account. Every business house for its own convenience keeps a "current" or operative account with a bank, and in its books it keeps an account for the recording of these transactions so that the bank may be shown as debtor or creditor as the result of them.

Bank Account.

It is commonly urged that the Bank Account is a Real Account, as it deals with a kind of property, but for the student it will doubtless be found that if the Bank Account be kept in the name of the bankers and the account treated as a Personal Account, no difficulty whatever will present itself in dealing with any banking transaction. The test then to be applied to any operation on the Bank Account would be, were the Bankers *receivers* or *givers?* If receivers the account would be Dr., if givers, Cr. The root of all difficulty in banking transactions, however, is that the student has not a sufficient knowledge of banking practice to enable him to comprehend the real nature of what takes place; it is therefore essential to state clearly the character of the commonest dealings which affect the Bank Account.

First, there are the "pay-ins." As the cash in hand accumulates the sum not required for immediate disbursement is paid into the Bank Account. The bankers are receivers, therefore Dr., and cash goes out, therefore Cr.

Secondly, the withdrawals. Cash is drawn from the Bank Account by cheques, the principal features of which will be explained immediately. As the cheque is our written authority to pay a specified sum and to charge our account therewith, it follows that every cheque must be credited to the Bank Account. If we issue a cheque in payment of a debt due by us to A B, the entry is A B (the *receiver*), Dr., Bank Account (the bankers are *givers*) Cr. Whenever we issue the cheque we should credit our bankers with the amount, as we cannot tell how soon thereafter it may be presented at our bankers for payment. On the Dr. side of the Bank Account, then, we

find all pay-ins, and on the Cr. all withdrawals; if the Dr. side exceed the Cr., the balance is the sum in bank, if the Cr. side is the greater, we have drawn out more than our own funds, and the bankers are our creditors for the excess, *i.e.* the balance at the Cr. of the Bank Account. We would speak of this excess of what has been drawn out over what we had paid in as a "bank overdraft."

Overdraft.

On opening an account with any banker the trader gets a pass-book in which his operations on the account are shown. The difference in the practice of the English and Scottish banks in this matter is worthy of mention. The pass-book of an English bank shows the trader to be Dr. for his cheques and Cr. for his pay-ins, that is, the pass-book is a copy of the *trader's account in the bank's Ledger;* the pass-book of a Scottish bank shows the bank to be Dr. for the pay-ins and Cr. for the cheques, that is, the pass-book is a copy of *the Bank Account in the trader's Ledger.* The balance shown on the Bank Account in the trader's Ledger should be frequently reconciled with the balance shown on the bank pass-book, so that discrepancies may be detected without loss of time. Usually any difference between the Bank Account and the bank pass-book is occasioned by cheques issued not having been promptly presented at the bank for payment; these cheques were duly credited in the Bank Account, but may not yet be in the pass-book, thus causing the difference.

Pass-Book.

When a Bank Account has been overdrawn interest accrues on such overdraft. The practice of the banks in securing payment of this interest is for the Bank to enter the amount of such interest, as if a cheque had been drawn for the amount, when the pass-book is handed in by the trader at the close of the bank's year to be balanced with the Bank's Ledger. On receiving back the pass-book, then, the trader should see what interest had been charged, and pass an entry through his books for the amount. Such an entry is—Interest was a loss, Interest Account Dr. — Bank became creditor, Bank Account Cr. Now a few practical points regarding

Bank Interest

cheques. A cheque is "(1) an order; (2) drawn upon a banker by his customer; (3) for a definite sum; (4) payable on demand; (5) to a specified person or his order or to bearer." Business men commonly use "Order" cheques, of which the form is—

Cheques—General.

FORM OF "ORDER" CHEQUE.

No.——— *No.*——— Edinburgh,———19——

——— To the Bank of Scotland, Edinburgh.

——— (Perforation) Pay to (Payee's name) or order

——— the sum of (Write amount fully in words, adding "Sterling"). 1d. Stp.

£ : : £ : : Stg. (Drawer's signature.)

The "payee" is the person to whom the cheque is made payable, the "drawer" is the person who draws the cheque, that is, he who signs the cheque.

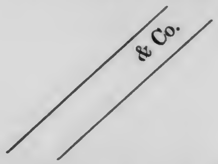
When a cheque is payable to A B or "order," it is necessary for A B to put his name on the back of it—that is, to "endorse" it—before the bank pays it. Should A B wish to pass it on to another party he might, firstly, merely sign his name on the back and hand it over, that is, he might endorse it "in blank"; or, secondly, he might write "Pay to C D or order" on the back and sign underneath this direction, that is, he might endorse it "specially." If the cheque form have the word "Bearer" in place of "Order," the cheque may be "negotiated," that is, passed on, without endorsement. That is to say, an order cheque is negotiated by endorsement and delivery, a bearer cheque is negotiated by delivery alone. On paying cheques into bank, then, it is necessary to have the payee's endorsement to all order cheques, but this can be dispensed with on bearer cheques.

Endorsement of Cheques.

In business circles it is the rule to "cross" cheques for

safety in transmission. To cross a cheque is to draw across its face two parallel lines and insert between them "& Co." (and company), thus—

Crossed Cheques.



When a cheque is thus crossed it cannot be cashed, it must be paid into a Bank Account. The benefit attaching to a crossed cheque is that in the event of its going astray in transmission, the finder cannot turn it to his own use. He could only pay it into his Bank Account, and on his bankers seeking to collect the amount from the bank on which it is drawn, they would probably be told that the drawer had stopped payment of the cheque as it had been lost. The foregoing is a "general crossing"; if it were crossed to any particular banker it would be a "special crossing," thus—

The effect of this special crossing is that the cheque can only be paid into a Bank Account with the Bank of Scotland. This is only used, of course, when a firm has the name of its bankers printed on its account forms for this purpose, or when the drawer is otherwise aware of the payee's bankers' name.

The crossing "Not Negotiable" sometimes seen on cheques does not prevent or restrict the negotiation of these cheques by endorsement in the ordinary way; this crossing merely transmits to anyone receiving such cheque any defect in title which the person giving it him had. For example, A finds a cheque which is so crossed, and dishonestly negotiates it (say, converts it into cash) through his friend B, to whom he endorses

the cheque. Even if B cash the cheque for A in good faith he must take the consequences, for A's right or title to that cheque was defective, and B could not acquire a better title than A had, by reason of this endorsement.

In writing out cheques the utmost care should be taken in filling in the amount. In the body of the cheque the sum should be written entirely in words, followed closely by the word "Sterling," and the space in the corner should have the amount in figures, followed by "Stg." When the shillings and pence are written in figures in both places falsification is rendered more easy. Should a cheque inadvertently be issued with the sum in words and that in figures differing, the amount payable is that appearing in words. Not infrequently cheques come to hand undated; any holder may insert what he believes to be the true date, and accordingly the date should be written in and the cheques negotiated in the ordinary course.

A common source of error with students of book-keeping is the treatment of customers' cheques. If we receive a cheque from A B in settlement of his account, our entry is, *Cash comes in*, therefore Dr., A B is *giver*, therefore Cr. The wrong notion which is got is that all cheque transactions are Bank Account items, and this cheque received from A B would accordingly find its way erroneously to the Dr. of Bank Account. All cheques on others' Bank Accounts are *cash* to us, like bank notes, money orders, and such like form of cash. Only our own cheques are bank transactions, and that because we by giving a cheque are merely asking our banker to pay on our behalf.

Cheques coming to us drawn on a banker at a distance have charges payable on them, but if they are drawn in our own locality or on London no charge is made.

The Journal.

It can readily be conceived that any attempt by a trader to write up his transactions into his Ledger accounts as they took place could only end in confusion. As a matter of practice nothing is ever entered in the Ledger without some other record having first been made of

The Journal.

the transaction; in other words, the Ledger accounts are posted up from other books. It was the custom at one time to pass every entry through the Journal, but now in good business houses it is commonly dispensed with except for the recording of certain adjusting entries. Every transaction is capable of being journalised, and as an exercise in resolving items into their Dr. and Cr. entries the use of the Journal is unrivalled. Indeed too much attention cannot be given by the student to journalising; when a transaction has been journalised all difficulty has been overcome, and only the clerical work of posting to the Ledger remains to be done. The Journal is "a book for classifying entries into debits and credits to facilitate the writing up of the Ledger accounts." The common ruling and a specimen of the setting out of an entry are as follows:—

Jan.	1	A B Dr.	17	56	4	9			
		To Cash	2				56	4	9

It will be seen from the foregoing example that a Journal entry is a bare statement of the names of the accounts concerned in the transaction, with the Dr. amount in the left-hand column and the Cr. in the right-hand column. The whole entry given above would be read, "January 1. A B, Dr. To Cash, £56, 4s. 9d." The figures in the folio column are the folios (or pages) of the Ledger to which the entries have been posted. The postings of the foregoing items are therefore—

On folio 17 A B's account is debited, "To Cash £56, 4s. 9d.," and on folio 2 Cash Account is credited, "By A B, £56, 4s. 9d."

Opening Entries.

For opening and closing entries, as they are called, the Journal is still highly important. If we desired to open a set of books on double entry principles our first steps would be to draw up a statement of our assets and liabilities as at the opening date. The assets would consist of debts due to the business and property of different kinds which the business possessed at that date; the

liabilities would be the debts owing by the business, and also the amount due to ourselves in respect of capital. Now, as our assets always equal our liabilities and capital, it is clear that when we have put all the assets on the Dr. side of their respective Ledger accounts and all the liabilities and also our capital on the Cr. of their appropriate Ledger accounts, the debits so entered would equal the credits. We would employ the Journal for such a process as the opening of the books, and the entries therefor, adopting the example of a Balance Sheet formerly shown, as the basis, would be thus:—

Jan.	1	Sundries, viz.:— Dr.							
		Customers' Accounts .		795	8	4			
		Goods		424	9	3			
		Plant and Fittings .		116	11	8			
		Bank		95	6	4			
		Cash		4	13	3			
		To Sundries, viz.:—							
		Creditors' Accounts . .					291	7	6
		Capital . .					1145	1	4
		Being assets and liabilities at this date . .							
				£1436	8	10	1436	8	10

In the posting of these entries the items Customers' Accounts and Creditors' Accounts would have to be posted in detail to the Personal Accounts of the customers and creditors from the lists of which the above figures are the totals. An alternative method of journalising the same example is to credit capital with the gross assets, viz. £1436, 8s. 10d., and debit capital with the outside liabilities, viz. £291, 7s. 6d., which is equivalent to crediting capital with a net sum of £1145, 1s. 4d., being the same result as above. The underlying argument for this latter method is that the capital of a concern is the surplus assets after providing for the liabilities. The former method is the preferable one, as it can be applied to the case of a partnership, whereas the latter cannot.

The foregoing entries shown journalised are such as would

be necessary on the opening of a new set of books, and the Journal would not thereafter be much in request until it was desired to balance the books at the close of a financial period. After the totals of the Trial Balance at the closing date have been agreed, certain entries are required to be made so as to bring out the true position of affairs; for example, the stock of goods on hand must be ascertained by the process of stock-taking, and a Journal entry for it should be made, thus—

Closing Entries.

Goods (New Account) Dr.
To Goods (Old Account)

This and the other entries necessary to close the books for the financial period are termed the "closing entries." These closing entries might be as follows:—

Goods Account	Dr.	To Profit and Loss Account for gross profit.
Profit and Loss Account	Dr.	To Wages Account, and also to all the other nominal accounts on which there is a Dr. balance to be transferred.
Creditors' Discounts Account and also all other nominal accounts with Cr. balances to be transferred	Dr.	To Profit and Loss Account.
And finally Profit and Loss Account	Dr.	To Capital Account for net profit.

These entries, adopting the figures in the examples shown before, would be journalised thus:—

Goods—New Account	Dr.	£424	9	3				
To Goods—Old Account for stock on hand carried forward.						£424	9	3
Goods Account	Dr.	1000	0	0				
Creditors' Discounts	Dr.	98	17	6				
Dividends Account	Dr.	43	4	5				
To Profit and Loss Account for profits transferred.						1142	1	11

Profit and Loss Account	Dr.	£1142	1	11				
To Wages and salaries						£473	12	6
„ Rent and taxes						126	10	0
„ Carriages						15	4	9
„ General charges						210	4	0
„ Bad debts and discounts for expenditure transferred.						50	2	8
„ Capital for net profit						266	8	0

The foregoing illustration adopts the figures given in the Trial Balance previously shown. If these specimen closing entries were posted to the Ledger from which the Trial Balance was taken the postings would close off all the nominal accounts. Take the Dividends Account for example. The Trial Balance shows us that at 31st December that account had credits of £43, 4s. 5d. To square this account it is necessary to debit it with an equal sum, and the Journal entry shown above debits Dividends Account and credits Profit and Loss Account. All the nominal accounts are similarly closed by having their balances, whether representing profits or expenditure, transferred to Profit and Loss Account, and the ultimate result is that the only balances left standing on the books are those which represent assets and liabilities. The items appearing in our specimen Trial Balance which are not written off by the foregoing specimen closing entries are those which appear in the Balance Sheet previously given. It should be noted, then, that the closing entries for a set of books must have the effect of leaving on the accounts only such balances as represent assets and liabilities of the business as at the closing date.

Bills of Exchange.

Bills play an important part in the settlement of debt of business houses, and before a student of book-keeping can hope to deal intelligently with transactions relating to them he must have acquired a knowledge of their principal features and the practice attending their use. We must first consider Bills of Exchange, then, without reference to book-keeping records.

The Bills of Exchange Act, 1882, defines a Bill of Exchange as "an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to or to the order of a specified person or to bearer." The following form of a bill will convey a more definite impression of its nature:—

Draft.

£124 : 3 : 9 Stg. Edinburgh, 26th April 19 .

Stp. 2s. One month after date pay to me or my order within the Bank of Scotland, Edinburgh, the sum of One hundred and twenty-four pounds Three shillings and Ninepence Sterling, value received.

To C D, Glasgow. A B.

This bill is drawn at one month's date—this is its "term"—and in ascertaining its "due date" we add three days for "days of grace." The foregoing bill is therefore due on 29th May. All bills, except those payable on demand, are due on the third day of grace after the expiry of their term. The bill is in the form of an order by A B upon C D, A B writes "Pay to me or my order." A B must be C D's creditor to entitle him thus to demand payment of the amount. The one who signs the bill is called the "drawer"—he draws on the other—and this bill may be spoken of as A B's "draft" on C D. The "payee" of a bill is the person to whom payment is to be made; it is A B himself in this instance, but he could have made it out, "Pay to E F or his order" instead, in which case E F would have been the payee. The "drawee" is he on whom the bill is drawn, C D in this case. He is clearly the debtor of A B, and has to meet the bill on its due date. A B after writing out this bill sends it to C D, and if he agrees to make payment of the amount on the due date, that is, accepts liability under it, he writes the word "Accepted" and his signature across its face. Another way of accepting a bill is to sign under the drawer's signature without the word "Accepted." Frequently traders write across the bills when accepting, "Accepted payable within the Royal Bank of Scotland," or elsewhere, and sign.

Acceptance.

The effect of this instruction is that the bill on its due date will be presented for payment in the Royal Bank of Scotland or other specified place instead of at the trader's business address. After the drawee has accepted the bill it may be spoken of as his "acceptance" to his creditors, and he himself is termed the "acceptor."

The terms of the foregoing bill indicate that the creditor (A B) drew upon his debtor (C D); but occasionally the form is in the wording of a promise by the debtor to pay to his creditor; thus—

Promissory Note.

£124 : 3 : 9 Stg. Glasgow, 26th April 19 .

Stp. 2s. One month after date I promise to pay to A B or his order the sum of One hundred and twenty - four pounds Three shillings and Ninepence Sterling, for value received.

C D.

The relation of the parties is the same as before, but here we have a promise signed by C D, the debtor, to pay to A B. This is called a "Promissory Note." This requires no "acceptance" by A B, it is complete as it stands. The foregoing are the two forms in general use in commerce.

In recording bill transactions in business books we make no distinction in our treatment of bills (*i.e.* drafts or acceptances) and promissory notes. The distinction which we do make is between bills *of which we are to receive payment* and those *which we must pay* when they mature or become due. Bills which we are to receive payment of we call "Bills Receivable," and we keep a Ledger account in this name for recording our dealings with them. The bills which we must pay on maturity we call "Bills Payable," and a Ledger account is kept in this name quite distinct from the other. As both these accounts deal with kinds of property, we consider them Real or Property Accounts, and we test the transactions with the question, Did that bill *come in* or *go out?* and debit or credit accordingly. No confusion need arise in the mind of the student in distinguishing between bills receivable and bills payable; we must be either pay*ers* or pay*ees* (expressly

Bills Receivable and Bills Payable.

or as endorsees) of every bill we handle. All of the former class are "Payable," and all the latter class "Receivable."

When we draw a bill on C D we send it on to him for his acceptance of it. When we receive it back duly accepted we have (1) a bill (of which we are to receive payment) *coming in*, and (2) C D giving it. Our entries must therefore be Bills Receivable Dr. for the bill receivable *coming in*, and C D Cr. as *giver*. Then from C D's point of view—When A B draws on us and we accept and return the bill, we have (1) a bill (which we must pay when due) *going out*, and (2) A B *receiving* it from us. Our entries are therefore A B Dr. as *receiver*, and Bills Payable Cr. for the bill payable *going out*.

Bill Entries.

If we receive C D's promissory note it is still a bill receivable coming in and C D giving; accordingly, Bills Receivable Dr. and C D Cr. And again, from C D's point of view—If we give our promissory note to A B it is again A B Dr. as receiver, and Bills Payable Cr. for our note going out.

On the due date of one of our bills receivable we might collect the amount direct from the acceptor. Our entry in such a case would be Cash Dr. for the cash *coming in* and Bills Receivable Cr. for the matured bill *going out*, it being handed back to the acceptor by us when we receive payment from him. The course more frequently adopted, however, is for a merchant to pay the bill receivable into his Bank Account and his bankers collect it for him. The entry then is Bank Account Dr., as bankers were *receivers* of the bill, and Bills Receivable Cr. for the bill *going out*.

On the due date of one of our bills payable it may be presented at our business premises for payment. We would then give cash or a cheque in payment, and our entries would be Bills Payable Dr., as the bill would *come in* to us, being given up by the holder on our paying it, and Cash Cr. if we paid it by cash, or Bank Cr. if we paid it by cheque. If we accepted the bill "payable within" our bankers' office, the bill would not be presented to us for payment but to our bankers, and they would charge our account with the amount. Our entry here is Bills Payable Dr. for the paid bill discharged, and Bank Cr. for the

payment made on our behalf. When a bill is duly paid it is said to be "met," "retired," or "honoured."

It is often expedient for a trader to turn his bills receivable into cash rather than hold them until their due dates. If we desired to carry through such a transaction we would take the bill to our banker and ask him to discount it for us. He would deduct from the amount of the bill "discount" (actually simple interest) at the current rate and give us credit for the "net proceeds." Take the case of a bill for £100 which we hold, and which has still seventy-three days to run, with the discount rate at 5 per cent. The present value of this bill is £99, deducting bankers' discount, and our transaction would then be—we have (1) paid the net proceeds of £99 into bank, (2) paid away as discount or interest £1, and (3) given to the banker a bill receivable for £100. Our entries thus would be, Bank Dr. for the £99, the proceeds which we paid into our account; Interest Dr. for £1, the loss in discount charged by the bankers; and Bills Receivable Cr. for the £100 bill which went out. We really sell the bill to the bankers for its present value, and instead of bringing away the cash we pay it into our Bank Account with them. We "endorse" all bills which we discount, that is, we sign our names across the back of these bills, and thereby become liable to meet the bills in the event of the acceptors failing to pay them when due.

Discounting Bills Receivable.

This consideration brings us to the question of bills which are not duly paid at maturity. These are termed "dishonoured bills." When we get a bill from a customer, A B, we debit Bills Receivable Account for the bill *coming in*, and credit A B, who *gives*. If he fail to meet his obligation, and we have the bill in hand at its due date, we only reverse the previous entry, crediting Bills Receivable for the bad bill, and debiting A B as our debtor on his personal account once more. Had we discounted A B's bill the position would have been different. In that case the bank would have presented the bill to A B for payment and failing settlement would have come back on us, as we were liable as endorsers, as already explained. We would give them a cheque on our Bank Account "to take up" the bill, and our entry

Dishonoured Bills.

would be—A B Dr. for the amount of the bill which we are paying on his behalf, and Bank Cr. for the cheque we have drawn. Note carefully, it is acceptor's account which is debited with the payment of the dishonoured bill; the payment was really made by us on his behalf, as we guaranteed the bill to the bankers when we endorsed it at the time of discounting. The amount to be paid by us under such circumstances would probably be a few shillings more than the sum in the bill in respect of the "Noting" costs; the whole amount payable nevertheless would be charged up to the debtor's account.

Renewed Bills. It is a common thing for an acceptor of a bill to ask his creditor not to demand cash payment of the whole amount on the due date, but to take part payment and a new bill for the balance. Such a transaction resolves itself into (1) cash received for the payment towards the old bill, (2) a new bill receivable *coming in*, and (3) the old bill receivable *going out*. In most cases the creditor only accedes to such a proposal in consideration of interest being added to the new bill in respect of postponement of payment of that part of the debt. It is very desirable that such transactions as this be fully passed through the debtor's Ledger account, so that at any time the whole course of the dealings may be shown. The entries for such a settlement as that suggested, assuming C D to be the debtor in the old bill, are:—

(1) C D Dr. for the old bill, which he gets back, Bills Receivable Cr. for that bill *going out*.
(2) Cash Dr. for sum received, C D Cr. as *giver* of that cash.
(3) C D Dr. for interest on the postponed payment, Interest Account Cr. for that interest *gained*.
(4) Bills Receivable Dr. for the new bill *coming in*, C D Cr. as *giver* of that bill.

If the bill stamp is also to be charged to the debtor his account would be debited with it and Petty Cash Account credited, as the bill stamp will have been paid for and charged through Petty Cash Account. If the bill be wholly renewed the complete transaction should be shown on the debtor's personal account. This transaction consists in the old bill being handed back in exchange for the new one of later date but for the

same amount. The entries here are—Acceptor's Account Dr. to Bills Receivable for the old bill, and Bills Receivable Dr. to Acceptor's Account for the new bill. The Acceptor's Account would thus show the history of our dealings with him, and as the dates of the bills differ and also the reference numbers given to the bills for distinction, renewed bills should be treated thus.

When it is agreed to renew a bill which we have discounted, it is necessary for us "to take up" the old bill which lies at the bank awaiting settlement, and we would receive the new bill from our debtor and might then discount that to restore our Bank balance to its former position. The transaction appears thus:—

(1) C D (the acceptor) Dr. for his bill which we are taking up for him.
Bank Cr. for the cheque which we draw for that purpose.
(2) Bills Receivable Dr. for the new bill *coming in*.
C D Cr. as *the giver* of that bill.

And if the new bill is to be discounted we would have further—

Bank Dr. for the net proceeds paid in to our account.
Interest Account Dr. for the discount charged by the bankers, and Bills Receivable Cr. for the bill which the bankers get.

If we renew one of our own acceptances, *i.e.* a bill payable, we must debit Bills Payable for the old bill (which *comes in* to us in exchange for the new one), and credit the payee or holder (A B) with it as *the giver*. Then on giving a new bill for the amount we would have A B (the drawer) Dr. as *receiver* of the bill, and Bills Payable Cr. for the bill *going out*. If we agreed to pay interest for the postponed settlement of our debt the entry for such interest would be, Interest Account Dr. for the amount charged, and A B Cr. for the interest payable to him, and the new bill would be for an increased amount to cover such interest, or the interest would be paid by us in cash. In any event, the whole course of our dealings with A B should be shown on his account in our Ledger, although this method does involve more entries than are necessary by the more direct but less satisfactory methods which may suggest themselves to the student.

Occasionally a trader holding an acceptance of one of his customers does not discount it but endorses it in favour of one of his own creditors, getting credit for the full value of the bill. Thus, if A B, who holds C D's bill, is indebted to E F for the same amount, he may endorse C D's acceptance in E F's favour. This transaction is—E F Dr. for the bill he *receives*, and Bills Receivable Cr. for the bill *going out*. The pitfall for students in this item is that a creditor's account is being settled by a bill *receivable* going out instead of a bill payable going out as is the usual case.

Endorsing.

From what has been said it will be observed that the holder of a bill may do one of three things with it, viz.:—

(1) He may hold it until the due date and collect the amount in full.
(2) He may endorse it over to a creditor for its full value.
(3) He may discount it, receiving its present value in cash or placing such net proceeds to his credit with his bankers.

Review of First Principles.

We have thus far been discussing merely the theory of account-keeping, making the correct writing-up of the Ledger Accounts concerned in the various transactions our one aim, and the preparation of a Balance Sheet from these Ledger Accounts at stated intervals has been considered as of the nature of a periodical review of the financial position. We must evolve some more practicable system of attaining these same results, however, and before proceeding to the discussion of this Practical Book-keeping let us recount the steps in the keeping of the accounts.

(1) If the business be new there will be no assets and liabilities at the opening date, and the first transaction will be the capital put in. If the business has been conducted prior to the opening of the new books a Balance Sheet must be drawn up as at the date on which the books are to be opened. All assets must be put to the Dr. of their appropriate accounts, and all liabilities to the Cr. of their appropriate accounts. Such assets and liabilities being

equal in their sum, the aggregate opening Dr. entries equal the aggregate opening Cr. entries.
(2) Every transaction must have a double entry, a Dr. and a Cr.
(3) A Trial Balance is to be taken off to prove the books after posting of the period's transactions is completed but before making the closing entries.
(4) Closing entries for stock on hand and any other items are now made, and the Nominal Accounts are then closed into Profit and Loss Account.
(5) The Balance Sheet as at the closing date will be prepared after the gross profit has been transferred to the Profit and Loss Account and the net profit transferred from there to the Capital Account; all Dr. Balances on the books to be stated as assets, and all Cr. Balances (including capital) as liabilities. The two sides of the Balance Sheet must agree in their sum, and the books would therefore be "on the balance" for the opening of the new period.

II.—MODERN PRACTICE

We have now seen that it is in the Ledger accounts that we have the double effect of each transaction shown, but it is no doubt clear to the student that in actual business life we could not enter the items in their appropriate Ledger accounts as the transactions occur, nor could we record the transactions individually in the Journal to be posted to the Ledger at leisure. Both courses are quite impracticable because of the clerical labour involved, and it therefore becomes necessary to group our transactions in some way to lessen the labour of posting. We thus come to deal with what are known as the "Books of Original Entry," so called because the entries for the transactions originate in them and are afterwards posted to the Ledger.

Books of Original Entry.

It will readily be understood that in commercial houses the transactions principally consist of goods received and sent away, cash received and paid, and bills received and granted. It will be found then that we can group all goods received into one book, all goods sent out in another, and so on, and in this way obviate much of the detail posting otherwise necessary. The books of original entry thus comprise:—

(1) The Cash Book for all cash receipts and payments.
(2) The Invoice Book for goods purchased.
(3) The Day Book for goods sold.
(4) Returns Books (Inwards and Outwards) for returns to us and returns by us.
(5) Bills Receivable and Bills Payable Books for bills received and granted.
(6) Journal for entries not applicable to any of the foregoing books.

It is necessary to consider each of these records separately, and in so doing the student should endeavour to keep in mind that each one is of itself incomplete, it is but a part of the book-keeping system as a whole. The attainment of the double entry through these separate books should be carefully followed, as it is only by an appreciation of their functions that the system can be regarded as an organic whole.

The Cash Book.

The Cash Book comes first in order of importance. There are many forms of Cash Book in common use, and the one to be adopted in any particular case must depend wholly upon the special circumstances obtaining. The Cash Book differs from the other books of original entry in this important respect—it is an account with a Dr. and a Cr. side; it is, in fact, merely the Cash Account which might appear in the Ledger but for convenience of posting is kept in the separate book bearing its name. The Cash Account is a Real Account, and as such is Dr. for all cash *coming in* and Cr. for all cash *going out*. We thus find that whatever form of Cash Book we employ we find the receipts debited and the payments credited. The entries on the Dr. side of the Cash Book must have corresponding entries on the Cr. side of the other account involved in the transaction; this Cr. entry is obtained by posting all items on the Dr. of the Cash Book to the Cr. of the appropriate Ledger accounts. Similarly, every entry on the Cr. side of the Cash Book must have a corresponding Dr. entry in the other account concerned in the transaction; this Dr. entry is obtained by posting every item on the Cr. of the Cash Book to the Dr. of its appropriate Ledger account. These rules should be borne in mind in the study of any illustrations of Cash Book forms.

Postings.

To bring out clearly the difference between the various forms now given we shall illustrate their uses by passing the same few supposed transactions for the first week of January through all of them.

Jan. 1. A trader has £53, 12s. in bank and £9, 8s. 4d. cash on hand.
„ 2. Paid A B by cheque, £18, 4s. 6d.
Received from C D in cash, £4, 5s., and allowed him discount, 1s. 6d.
Bought goods for cash, £7, 3s. 2d.
„ 3. Paid E F by cheque £10, and was allowed discount, 3s. 9d.
„ 5. Cheque cashed, £24.
Drew cash for his own expenses, £5.
„ 7. Received from G H his cheque for £37, and allowed him discount, 8s. 3d.
Paid into bank, £40.
Paid wages, £5, 12s.; paid charges, £3, 10s. 9d.

CASH BOOK—*Form I.*

		Fol.				Fol.	
Jan. 1.	To Balance .		£9 8 4	Jan. 2.	By A B . .		£18 4 6
„ 2.	„ Bank (A B)		18 4 6		„ Discount (C D)		0 1 6
	„ C D . .		4 6 6		„ Goods . .		7 3 2
„ 3.	„ Bank (E F) .		10 0 0	„ 3.	„ E F . .		10 3 9
	„ Discount (E F)		0 3 9	„ 5.	„ Capital . .		5 0 0
„ 5.	„ Bank . .		24 0 0	„ 7.	„ Discount (G H)		0 8 3
„ 7.	„ G H . .		37 8 3		„ Bank . .		40 0 0
					„ Wages . .		5 12 0
					„ Charges . .		3 10 9
					„ Balance . .		13 7 5
			£103 11 4				£103 11 4
Jan. 8.	To Balance . .		£13 7 5				

The foregoing style of Cash Book is similar in form to a Ledger account. From the transactions passed through it will be noted that when payments are made by cheque the actual payment appears on the Cr. or payments side, and an entry is made on the Dr. side "To Bank" for the amount of such cheque. The Cr. entry would be posted to the Dr. of the creditor receiving the cheque or such other account as ought to be debited, and the Dr. Cash Book entry would be credited to Bank Account. When a debtor settles his account and we allow him discount, we enter the gross sum as received from him, and then enter the discount as paid out,

Simplest Form.

the effect of such entries being equivalent to debiting cash with the net sum received. See entries for C D and G H above. The gross Dr. Cash Book entry is credited to the customer's account, and the Cr. Cash Book item is debited to Discount Account. For the sake of illustration the example shown is balanced at 7th January by crediting the amount necessary to square the two sides and carrying down the balance so obtained to the Dr. side to begin the new week's account. This balance should of course agree with the actual cash on hand at the time of balance. A Cash Book is occasionally met with which is kept on the same principles as the foregoing, only its Dr. and Cr. columns are side by side, like a Journal ruling. The entries in such a Cash Book would be exactly similar to those appearing above, but the word "To" or "By" would have to be prefixed to each entry, as the ruling would necessitate all the items being written in in chronological order, and the Dr. and Cr. narrations would thus be mixed, but the amounts would be extended to their respective cash columns.

To obviate the unnecessary entries in transactions involving discount, which occur in Form I., a special column for its treatment is often added to each side of the Cash Book, as follows:—

CASH BOOK—*Form II.*

		Fol.	Discount.	Cash.			Fol.	Discount.	Cash.
Jan. 1.	To Balance			£9 8 4	Jan. 2.	By A B .			£18 4 6
„ 2.	„ Bank .			18 4 6	„ 3.	„ Goods .			7 3 2
	„ C D .		£0 1 6	4 5 0		„ E F .		£0 3 9	10 0 0
„ 3.	„ Bank .			10 0 0	„ 5.	„ Capital			5 0 0
„ 5.	„ Bank .			24 0 0	„ 7.	„ Bank .			40 0 0
„ 7.	„ G H .		0 8 3	37 0 0		„ Wages .			5 12 0
						„ Charges			3 10 9
						„ Balance			13 7 5
			£0 9 9	£102 17 10				£0 3 9	£102 17 10
Jan. 8.	To Balance		.	£13 7 5					

In this form the discount columns are the new features, and it is therefore only necessary to refer to the treatment of the discounts by their use. When C D came to settle his account of £4, 6s. 6d. we agreed to accept £4, 5s. We actually receive £4, 5s. in cash and debit Cash therewith, and we allow him discount of 1s. 6d.; that is dis-

Discount Cols.

count lost, therefore Discount Dr. In posting this item from the Dr. of the Cash Book we credit C D "By Cash and Discount," £4, 6s. 6d., being the two items taken together. When we settle our debt of £10, 3s. 9d. to E F by a payment of £10, we Cr. Cash with the actual sum paid and Cr. Discount with the 3s. 9d. gained. In posting this to E F's account we Dr. him "To Cash and Discount," £10, 3s. 9d., being the two items together. The cash columns are balanced against each other as before and the balance carried down. The discount columns are sometimes balanced against each other, and only the difference posted to the Discount Account in the Ledger. It is usually desirable, however, to know the total discounts allowed to and by us, and it is therefore advocated as a preferable method to post the Dr. discounts (9s. 9d. above) to the Dr. of Discount Account, and the Cr. discounts (3s. 9d. above) to the Cr. of Discount Account. The Discount Account will, by the use of these columns, only have posted to it the periodical totals instead of the full details of all discounts.

Bank Cols. The next improvement in the form of Cash Book that will suggest itself to the student is one which would obviate the necessity for dealing with cheque payments in the double manner required in the two forms given, viz., crediting cash with the payment made and debiting it with the cheque drawn therefor. This important improvement is attained in the form now given (III.), in which an extra column is added to each side of Form II., these extra columns being wholly appropriated to bank transactions and taking the place of a Bank Account in the Ledger. The use of a Cash Book dispenses with the Cash Account in the Ledger, and the insertion of bank columns in the Cash Book makes it possible to dispense also with a Bank Account in the Ledger. It must be remembered, however, that the use of discount columns in the Cash Book does not get over the need for a Discount Account. The cash and bank columns can be balanced and the balances carried down in the Cash Book, whereas the discount column totals must be transferred to the Discount Account, which at balancing time will be transferred to Profit and Loss Account. The same series of transactions is used in the following example for purposes of comparison:—

CASH BOOK—*Form III.*

	Fol.	Discount.	Bank.	Cash.		Fol.	Discount.	Bank.	Cash.
		£ s. d.	£ s. d.	£ s. d.			£ s. d.	£ s. d.	£ s. d.
Jan. 1. To Balances			53 12 0	9 8 4	Jan. 2. By A B			18 4 6	
„ 2. „ C D		0 1 6		4 5 0	„ Goods				7 3 2
„ 5. „ Bank				24 0 0	„ 3. „ E F		0 3 9	10 0 0	
„ 7. „ G H		0 8 3		37 0 0	„ 5. „ Cash			24 0 0	
„ Cash			40 0 0		„ Capital				5 0 0
					„ 7. „ Bank				40 0 0
					„ Wages				5 12 0
					„ Charges				3 10 9
					„ Balances			41 7 6	13 7 5
		0 9 9	93 12 0	74 13 4			0 3 9	93 12 0	74 13 4
Jan. 8. To Balances			41 7 6	13 7 5					

The real nature of the transactions treated is more apparent by this method of treatment than by either of the previous

styles. All cheques drawn on the Bank Account are inserted in the bank column on the Cr. side, and all pay-ins to the Bank Account are entered in the bank column on the Dr. side. Attention is particularly directed to the cheque cashed on 5th January and also the pay-in to bank on 7th January. The entry for the cheque cashed is Cash Dr. for cash *coming in*, and Bank Cr., the bankers being *givers*. Accordingly in the Cash Book we have Cash Dr. "To Bank" and Bank Cr. "By Cash." These entries require no posting, of course, each is the complement of the other, and a tick or cross reference is put in the folio column instead of a folio. The entry for the pay-in is Bank Dr., the bankers being *receivers*, and Cash Cr. for cash *going out*. We accordingly have in the Cash Book, Bank Dr. "To Cash," and Cash Cr. "By Bank." These items also require no posting, the cash and bank columns being equivalent to Ledger accounts, and both the Dr. and Cr. entries are found in the Cash Book alike for pay-ins and cheques cashed. Apart from these two transactions the postings would be as before—all credits on the Cash Book to the Dr. of Ledger accounts, and all debits on the Cash Book to the Cr. of Ledger accounts, and the totals of the discount columns to their respective sides of the Discount Account in the Ledger. The method of carrying down the Cash and Bank balances side by side should also be noted. It not infrequently happens that there is a bank overdraft, in which case the Bank balance would be carried down to the Cr. side instead of appearing on the Dr. The Cash balance, if any, must invariably be a Dr. balance.

In certain classes of business no discount transactions occur. For this character of business the discount columns can be omitted from the foregoing example of Cash Book and the columns for cash and bank, both Dr. and Cr., used as in the illustration.

Columnar or Analytical Form.

There is another style of Cash Book which has come greatly into use in recent years, and which we shall have occasion to examine more closely hereafter in another connection. This is the columnar form of Cash Book—a Cash Book based upon the last example, and giving in addition, for both Dr. and Cr. sides, analytical columns for the purpose of classifying the receipts and payments. A short illustration is here given with the same items as formerly passed through.

Cash Book—*Analytical or Columnar Style.*

Other Receipts.			Fol.	Sales.			Discount.			Bank.			Cash.					
£	s.	d.		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.			
										53	12		9	8	4	Jan.	1	To Balances
																	2	By A B . .
				4	5			1	6				4	5				To C D . .
																		By Goods . .
																	3	,, E F . .
													24				5	Cheque cashed
																		By Capital. .
				37				8	3				37				7	To G H . .
										40								Paid into bank
																		By Wages . .
																		,, Charges .
																		,, Balances .
				41	5			9	9	93	12		74	13	4			
										41	7	6	13	7	5	Jan.	8	To Balances

			Cash.			Bank.			Discount.			Fol.	Purchases.			Charges.			Wages.			Rent and Taxes.			Other Payments.		
			£	s.	d.	£	s.	d.	£	s.	d.		£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
Jan.	1	To Balances																									
	2	By A B . .				18	4	6					18	4	6												
		To C D . .																									
		By Goods . .	7	3	2								7	3	2												
	3	,, E F . .				10				3	9		10														
	5	Cheque cashed				24																					
		By Capital. .	5																						5		
	7	To G H . .																									
		Paid into bank	40																								
		By Wages . .	5	12															5	12							
		,, Charges .	3	10	9											3	10	9									
		,, Balances .	13	7	5	41	7	6																			
			74	13	4	93	12			3	9		35	7	8	3	10	9	5	12					5		
Jan.	8	To Balances																									

From a style of Cash Book similar in type to this example an abstract of the cash transactions can be prepared very readily on the following model:—

Abstract of Cash Transactions.

Receipts.	£ s. d.	*Payments.*	£ s. d.
Jan. 1. To Balances :—		Jan. 7. By Purchases .	£35 7 8
Bank . .	£53 12 0	„ Charges . .	3 10 9
Cash . .	9 8 4	„ Wages . .	5 12 0
	£63 0 4	„ Drawings . .	5 0 0
		„ Balances :—	
		Bank £41 7 6	
„ 7. To Sales (Customers' Accounts) . .	41 5 0	Cash 13 7 5	54 14 11
	£104 5 4		£104 5 4

As most social clubs and charitable institutions and associations keep their accounts on a cash basis, and publish their accounts in the form of an abstract of the treasurer's intromissions with the funds, this style of Cash Book is invaluable in such a connection. It is also very serviceable to retail traders whose book-keeping must be simplified to accord with the limited character of their dealings.

The Invoice Book.

The Invoice Book is the original record for all purchases of goods on credit, and it should be strictly kept for such. The treatment of Cash Purchases is explained hereafter. The Invoice Book is otherwise variously termed "Purchase Book," "Purchase Day Book," "Purchase Journal," and "Bought Day Book." When we purchase goods from a wholesale house our entries must be Goods Account Dr. and the Seller's Account Cr. As all purchases must be Goods Dr., the Invoice Book is kept for the purpose of grouping together those purchases and then transferring the total of those grouped items to the Dr. of Goods Account in one sum. The benefit accruing from this grouping is thus a great saving of posting. The ordinary Invoice Book is ruled like a Journal with the two money columns side by side, thus:—

Invoice Book—*Form.*

C. D.

Jan.	3	20 Qrs. Wheat at 31s. 6d. . .		£31 10 0	
		10 Qrs. Barley at 24s. . .		12 0 0	£43 10 0

The first erroneous conception the student entertains with regard to both the Invoice Book and the Day Book is that their two columns are respectively for debits and credits. They are not. The inner money column of the two is for the detail of the order, whether a sale or a purchase, and the outer column is for the total item to be posted. The specimen entry given above will illustrate the style of writing up the Invoice Book—the creditor's name on the first line, then the items copied from the invoice one by one, their amounts appearing in the first column and the total of the invoice extended as shown. An invoice is a note of the quantity, description, and prices of goods sold, and is sent by the seller to the purchaser either with the goods or by post about the time of delivery of the goods. The Invoice Book is posted by having each item credited to the seller of the item, thus C D in the specimen entry would be credited with, "January 3. By Goods, £43, 10s." The seller is Cr. because he is *giver* of the goods. It is unnecessary to detail the items in the creditors' accounts when posting the Invoice Book, the reference folio in the Ledger account would show on what page of the Invoice Book the entry appears, and it could be referred to if necessary. When the item is posted to C D's account his folio would be inserted in the folio column of the Invoice Book, opposite the £43, 10s. The purchases over the period would thus be regularly credited to the Personal Accounts of the sellers, and the Invoice Book would be kept summed up to date. At the close of each month or any other convenient period, the total—which would represent the value of the goods purchased (come in) over the period—would be debited to Goods Account. The Invoice Book thus has its separate items credited to the sellers and its total debited to Goods Account, thereby meeting the requirements of the double entry principle of equal debits and credits.

Postings.

The clerical labour involved in copying the received invoices into the Invoice Book as is required by the above

method is considerable, and may be obviated by employing one or other of the following alternatives.

Reference System.

The first alternative method may be designated for distinction the "Reference System." The ruling required in its simplest form is:—

Date.	Ref. No.	Creditor's Name.	Bot. Led. Fol.	Amount Invoiced.

Every invoice received is numbered and then recorded as to its date, reference number, creditor's name, and the amount. Every such entry is posted, as before, to the creditor's Ledger account with the simple narrative, "By Goods"; no details of the purchase appear either in the Invoice Book or in the account. The invoices, after being recorded, are folded to a uniform size, arranged in their numerical order, and bundled. Each month's invoices may begin a new number series and the name of the month be used as part of the reference, thus:—Jan./47. In this way the original invoice may be readily referred to for particulars when required. It is more convenient for reference to file the invoices unfolded in a spike or clip file, in which case the reference numbers are written on the face of the invoice in colour. The periodical total of the Amount column is debited to Goods Account, as before.

The second alternative is especially useful where it is desirable, considering the nature of the business, to have the purchases analysed, but it may also be advantageously employed where the Reference System is inconvenient on account of frequent references being made to the details of the invoices. This method is generally known as the "Guard Book" System. It combines the detail of the first system with the labour-saving short record

Guard Book System.

of the second. The book itself in its characteristic features contains date column, space for particulars, posting folio column, and amount column. Every invoice as received is folded up into a narrow strip, and, by a touch of paste or gum on its back at the top, is fixed into the Invoice Book in the narration space. The creditor's name and the amount may be backed on it. The date is entered alongside in the date column and the amount in the cash column, the posting folio also being inserted when the item is duly posted. If details of the purchase are required the original invoice is thus available at hand. The periodical total of the Amount column would be debited to Goods Account, as before, thus giving a debit equal to the aggregate of the items credited to the sellers' personal accounts.

Other variations of the form of the Invoice Book are given in treating of Departmental Accounts.

The Day Book.

The Day Book is the original record of all sales of goods on credit, and it should be exclusively appropriated to such purpose; the treatment of cash sales is specially explained hereafter. The Day Book is otherwise known as the "Sales Day Book," "Sales Journal," and "Sales Book," and it performs in the treatment of sales the same functions as the Invoice Book does for purchases. The ordinary ruling of the two is exactly similar, consisting of date column, space for particulars, folio column, and two cash columns. It is necessary again to caution the student against imagining the Day Book to possess a Dr. and Cr. side. The two columns shown in its ruling are for the same purpose as the two in the Invoice Book, the inner for the details of the order, and the outer for the extension of the total. When we sell goods to a customer our entries must result in debiting the customer who is a *receiver*, and crediting Goods Account for the goods going out. In posting the Day Book, then, the individual items must be debited to the customers, and the total sales as shown by its summation—representing the total value of the goods which have gone out during the period—must be credited to Goods Account. The Day Book thus has its items separately debited in the customers' Per-

Postings.

sonal Accounts and its total credited to the Goods Account, thereby meeting the requirements of the double entry principle of equal debits and credits.

If a record of the details of the sales to the customers is kept by press-copy of the invoice sent to the customer, it is obviously unnecessary to re-write that invoice *in extenso* into the Day Book; if the Day Book entry contain the date, name of customer to be debited, reference folio of the press-copy book on which the details are to be found, and the amount to be debited, these points would give the essential features of the Day Book entry and save much clerical labour.

Another method which is obtaining favour in some houses is that of keeping loose-leaf Day Books, and as the invoice to the customer is being typed a carbon copy is taken on a loose-leaf which is, when full, inserted in the binder to serve as a Day Book record of the transaction. These loose-leaves have double money columns provided so that the total of each invoice can be extended to the outer column to be included in the summation of the period's sales.

A carbon copy can also be taken of written invoices in a duplicate book, and the Day Book gives the reference to such copy in the same way as with the press-copy already referred to.

In large businesses it is necessary to have two or more Day Books running concurrently. They may be used on alternate days, so that while one is being written up for the day's transactions the other is being posted. Again, separate Day Books may be used for town trade and country trade, or for such other subdivisions as may commend themselves under particular circumstances. The primary end to be served by a Day Book is to facilitate the postings of the transactions to the Dr. of the receiving customers and their aggregate to the Cr. of the Goods Account, and whatever method attains that with a minimum of labour may be adopted, consistent with the attainment of other advantages necessary for the efficient management of the business.

The Returns Books.

In every business in which purchases and sales of goods on credit form a part of the general transactions it is inevitable that at times goods be returned by customers or to wholesale

houses, either from nonconformity to order, defect in quality, or other reason. These returns naturally divide themselves into two classes, the returns to us by customers, and the returns by us to creditors. The record of these returns would therefore consist of two divisions corresponding to the nature of the transaction; thus we find it necessary to keep a Returns Inwards Book for recording goods returned to us, and a Returns Outwards Book for recording goods returned by us. It is by no means an uncommon practice to enter Returns Outwards through the Day Book, thereby treating them as sales to the creditors, and to enter Returns Inwards through the Invoice Book, thereby treating them as purchases from the customers. Such a practice is to be strongly deprecated; it does not recognise that Returns Inwards are really sales cancelled, the items returned to us having been first entered in the Day Book as sales, and instead of treating a return as a purchase it should be deducted from the Day Book to give the actual sales. The same objection conversely stated applies to Returns Outwards being passed through the Day Book as sales, whereas they are really deductions from the purchases shown in the Invoice Book, the items returned having been passed through the Invoice Book when they were purchased. The Returns Books are similar in ruling to the Invoice Book and Day Book; the inner column is utilised for details of the return, and the total of the transaction is extended to the outer column.

Returns Inwards Postings.

The Returns Inwards Book contains the record of the returns by customers to us. Our entry must result in debiting Goods Account (or reducing the Cr. item of sales) for the goods *coming in*, and crediting the account of the customer as *giver*. The separate items of the Returns Inwards Book are accordingly posted to the Cr. of the customers' accounts, and the total of the returns for the trading period is posted to the Dr. of Goods Account.

Allowances to Customers.

In addition to actual returns of goods by customers there are commonly miscellaneous allowances and abatements which have been arranged with the customer to settle differences, possibly as to quantity delivered, quality supplied, misunderstanding as to terms, etc. These allowances must individually be credited to the customers to

whom they are made. Consequently the Returns Inwards Book in which all such entries originate is sometimes spoken of as the "Credit Journal"—the book recording credits (to the customers), as the name implies.

The Returns Outwards Book contains the record of the returns by us to creditors, and our entries must result in debiting the accounts of the creditors as *receivers* of the returned goods, and crediting the Goods Account for the goods *gone out*. The separate items in the Returns Outwards Book are thus posted to the Dr. of the creditors' accounts, and the total of the returns for the trading period is posted to the Cr. of Goods Account.

Returns Outwards Postings.

In addition to actual returns of goods to creditors there may be allowances and abatements claimed and admitted to settle differences; these miscellaneous allowances are passed through the Returns Outwards Book as if goods had actually been returned to the creditors granting such abatements. These items will be individually debited to the creditors' personal accounts, and will of course be included in the total returns outwards credited to Goods Account. The fact that these miscellaneous abatements to be debited to creditors find their way through this book frequently gives it the designation "Debit Journal."

Allowances by Creditors.

PURCHASES AND SALES ACCOUNTS.

To be strictly accurate in the Sales item to be stated in our Goods Account we should deduct the total of the Returns Inwards Book from the Day Book total instead of posting it to the Dr. of Goods Account as a separate item, for the returns inwards are cancelled sales, and such sales are included in the Day Book total. Likewise, to show our actual completed purchases we should deduct the total of the Returns Outwards Book from the Invoice Book total before debiting the latter to Goods Account, instead of crediting the returns outwards as a separate item in Goods Account, for these returns entries are the cancelling entries for purchases which appear in the Invoice Book.

The best plan for dealing with the totals of the Returns Books, however, is the keeping of an account called "Purchases Account" and another called "Sales Account." These accounts would have to be regarded as subdivisions of the Goods Account, to which their balances would be transferred when the books were being closed. The Purchases Account would be debited with the monthly total of the Invoice Book and credited with the monthly total of the Returns Outwards Book. The balance on the account at balancing date would then represent the actual or net completed purchases, and would be transferred to Goods Account by crediting Purchases Account "By Goods Account" and debiting Goods Account "To Purchases Account."

Purchases Account.

The Sales Account would be credited with the monthly total of the Day Book (representing the gross sales recorded) and debited with the monthly total of the Returns Inwards Book (representing the cancelled sales). The balance on the account would represent the net sales for the period, and would be transferred to Goods Account by debiting Sales Account "To Goods Account" and crediting Goods Account "By Sales Account."

Sales Account.

CASH SALES AND CASH PURCHASES.

When a cash sale takes place, that is, when goods are sold for ready money, the accounts concerned are obviously Cash and Goods. The cash received must be debited in the Cash Book "To Goods," and from there it might be posted to the Cr. of Goods Account; it cannot appear in the Day Book, as it is not a sale of goods on credit, to which class of entries the Day Book must be strictly appropriated. The posting of all the cash sales from the Dr. of the Cash Book to the Cr. of Goods Account would entail many entries in the Goods Account, which account it is desirable to keep as much as possible in the form of a summary. The cash sales should therefore be posted from the Dr. of the Cash Book to the Cr. of a special account "Cash Sales." This account at the time of balancing the books would be closed by a Dr. entry "To Goods Account," and Goods Account would show a corresponding Cr. entry "By Cash Sales."

Cash Sales.

Similarly, the cash purchases should be posted from the Cr. of the Cash Book to the Dr. of a "Cash Purchases Account," and this account at the date of balancing would be credited "By Goods Account" and Goods Account

Cash Purchases.

debited "To Cash Purchases." In this way the Goods Account would show its items only in total as brought from the four subsidiary accounts referred to, and would appear thus:—

Goods Account.

Dr.					*Cr.*				
July 1.	To Stock brought forward	£800	0	0	Dec. 31.	By Credit Sales (per Sales Account)	£1741	13	3
Dec. 31.	" Credit Purchases (per Purchases Account)	1263	17	8		" Cash Sales	96	5	9
	" Cash Purchases .	31	2	4		" Stock carried down .	850	0	0
	" Gross Profit to Profit and Loss Account .	592	19	0					
		£2687	19	0			£2687	19	0
Jan. 1.	To Stock brought down .	£850	0	0					

The Bill Books.

The bill transactions consist of two distinct classes of dealings, and it is necessary to keep separate books in which to record these two separate groups of bill items. One book deals exclusively with the bills payable, and is therefore termed the Bills Payable Book; the other is exclusively appropriated to bills receivable, and is therefore called the Bills Receivable Book. The first important point in connection with these books is that they do not supersede the Ledger accounts for bills receivable and bills payable, they merely serve to group the items over a period in the same manner as the Invoice and Day Books group the goods transactions. The Bills Receivable Book is for recording with full particulars all bills receivable granted (or endorsed) to us; the Bills Payable Book is for recording with full particulars all bills payable granted by us. The rulings of the two bill books are different, and both are therefore shown, and a specimen entry is given in each.

Bills Receivable Book.

When Received.	No.	From Whom Received.	Drawer.	Drawee.	To Whom Payable.	Where Payable.	Amount. £	s.	d.	Date.	Term.	Due Date.	Ledger Folio.	Cash Book Folio.	Remarks.
April 28	14	C D	Self	C D	Self	Bank of Scotland	124	9	3	April 26	1 m/d	May 29	32	81	Discounted 29/4/19...

The specimen entries relate to the specimen bill given previously. A bill receivable must be credited to the account of the customer giving it, and at the end of the month or other convenient period the Amount column is summed and the total transferred to the Dr. of the Ledger account kept in name of Bills Receivable. In this way we have the double entry. The Ledger folio shown in the specimen entry is the page on which C D's account appears, to the Cr. of which the item has been posted. The Cash Book folio given is not a posting folio, but merely a reference to the page of the Cash Book on which the entry relating to the discounting transaction appears.

Bills Receivable.

When Bills receivable are discounted or met at maturity the original entry for the cash received appears on the Dr. side of the Cash Book and is posted from there to the Cr. of Bills Receivable Account in the Ledger. As Bills Receivable Account in the Ledger is thus debited from the Bills Receivable Book with the periodical total of all the bills granted to us, and is credited from the Cash Book with the cash received for such of those bills as have matured or been discounted, accordingly, any balance standing on Bills Receivable Account should invariably be a Dr. balance and should agree with the amount of the bills still to mature and which are undiscounted, *i.e.* bills of which we have yet to receive payment.

Bills Payable Book.

When Granted.	No.	To Whom Given.	To Whom Payable.	Where Payable.	Amount. £	s.	d.	Date.	Term.	Due Date.	Ledger Folio.	Cash Book Folio.
April 27	63	A B	A B	Bank of Scotland, Edinburgh	124	3	9	April 26	1 m/d	May 29	74	131

The specimen entries shown are for the same bill as before, but in this case the entries are in C D's books. The bill is to him a bill payable, whereas to A B it was a bill receivable. The individual bills granted have to be debited to the parties receiving them, and at the end of the month or other convenient period the Amount column is summed and the total credited to Bills Payable Account in the Ledger. The Ledger posting folio shown in the specimen is that of the page on which A B's account appears, this bill having been placed to his debit. The Cash Book folio is not a posting folio, but merely a reference to the Cash Book entry of the final disposal of the bill by payment. When Bills Payable have been met the entry appears on the Cr. side of the Cash Book and is posted from there to the Dr. of Bills Payable Account in the Ledger. As this Bills Payable Account is thus credited from Bills Payable Book with the total bills granted, and is debited from the Cash Book with such of those bills as have been met, any balance on the Bills Payable Account in the Ledger should invariably be a Cr. balance, and such balance should agree with the amount of the bills not yet matured, that is, falling due on dates subsequent to the date of the balance.

Bills Payable.

The Journal.

The Journal has been given as one of the books of original entry, but its importance has been greatly lessened in recent years, and when it is still used in its simple form its recognised functions now are to record opening and closing entries and to show such adjusting entries between Ledger accounts as may be rendered necessary to rectify errors and make other transfers. It can quite well be dispensed with, as it merely classifies these few entries into debits and credits to facilitate the posting of them to the Ledger. For certain of the expert balancing methods, however, its employment with a special design is indispensable, as will be afterwards shown.

Postings Summarised.

It may be advantageous to recapitulate the general features of the books dealt with so far as regards their postings. Apart from the Journal, the books discussed are appropriated to the recording of transactions in three classes of commodities, viz. Cash, Goods, and Bills. The Cash Book relates solely to cash transactions, and it is different from the other books in that it is really a detached Ledger Account, and consists of Dr. and Cr. sides. The Goods books are the Invoice Book, Day Book, Returns Inwards Book, and Returns Outwards Book; these are used for grouping together over periods of one month or other specified time as may be suitable, items of a like nature to facilitate their treatment in posting and thus lessen labour. The Bill Books are the Bills Receivable Book and Bills Payable Book; their functions as regards bills are identical with those of the Goods books just referred to. As regards the various Goods books and the two Bill Books we can condense the principles of their postings thus:—

Day Book Returns Outwards Book Bills Payable Book	The Personal Accounts of the receivers to be debited with their respective items; The Real Account concerned to be credited with the total for the period.

Invoice Book Returns Inwards Book Bills Receivable Book	The Personal Accounts of the givers to be credited with their respective items; The Real Account concerned to be debited with the total for the period.

The Ledger.

Divisions of the Ledger.

The student should now be familiar with the form and general features of the different classes of accounts to be found in the Ledger. In practical life it would be very inconvenient to keep all the accounts within the compass of one book and subdivisions are therefore the rule. The recognised main division is into (1) Customers' Ledger (termed also the Debtors' or Sold Ledger); (2) Creditors' Ledger (termed also the Bought or Invoice Ledger); and (3) General Ledger. Further subdivisions may be necessary for any particular business, especially in the customers' section; such subdivision may be alphabetical or geographical, *e.g.* one section A-M, another M-Z; or one section Town, another Country. In commercial houses the Customers' Ledgers will be debited from the Day Book and credited from the Returns Inwards Book, Bills Receivable Book, and Cash Book. The Creditors' Ledger will be credited from the Invoice Book and debited from the Returns Outwards Book, Bills Payable Book, and Cash Book. The General Ledger contains the Real and Nominal Accounts, that is, it contains all that relates to the internal economy of the business, whereas the Customers' and Creditors' Ledgers show the relations with outsiders. The General Ledger will be posted up from the Cash Book principally, but the periodical totals of Invoice Book, Day Book, Returns Books, and Bill Books will also find their destination in their Real Accounts kept within its compass.

Outstanding Charges and Unexpired Expenditure.

In business circles it is the exception rather than the rule to have all the charges incurred paid up to date, and, on the other hand, any date throughout the year finds certain charges

paid from which a part benefit is still to be reaped. Familiar examples of the former are railway carriages, and gas and electric lighting. These are of the nature of current charges which are incurred in the ordinary course of business but not invoiced like the purchase of goods. Instances of unexhausted expenditure are found in insurance premiums and taxes. In every case insurance premiums are payable at the beginning of the risk and consequently it is the usual thing to find a portion of the insurance year still to run when the trader's books are being balanced for the period. Taxes are commonly paid during the currency of the year for which they are levied, and if the trader balances his books after he has paid his taxes but before the fiscal period covered by them elapses, a portion of such payment is really beforehand. It must be kept in mind that a trader's Profit and Loss Account must embrace the whole income and expenditure for the financial period, whether his income has been wholly received and his expenditure wholly paid or not. Income is not receipts but what is receivable as income, and expenditure is not payments but what is payable as outlay. Accordingly, when a trader has completed his financial period he must debit to his Nominal Accounts the items incurred though unpaid, and credit any income earned but not actually received up to the date of his Balance Sheet.

Outstanding Charges.

There are three ways of charging up outstanding charges in his books, and an illustration will be given of each of these methods.

First Method.

Take first the most direct and simple method, using Carriage Account for the illustration :—

Carriage Account.

Dr.						*Cr.*			
Sept. 10.	To Cash .	. £14	3	6	Dec. 31.	By Profit and Loss Account	£38	5	6
Dec. 13.	„ „ .	. 16	15	9					
„ 31.	„ Balance (Account outstanding)	. 7	6	3					
		£38	5	6			£38	5	6
					Jan. 1.	By Balance .	£7	6	3

The Carriage Account shown here should include the whole expenditure under that head for the half-year ending 31st December. The payments debited to the account from the Cash Book amounted at the time of balancing to £30, 19s. 3d., but an item of £7, 6s. 3d. had been incurred and was unpaid. The real expenditure on carriage for the half-year was therefore not £30, 19s. 3d. but £38, 5s. 6d. The amount unpaid is debited to the period's Carriage Account as "To Balance," and this admits of the correct expenditure being transferred to Profit and Loss Account. Having debited the account with the outstanding item, a corresponding credit must be made for it, and this is done in the new period's account. It will be seen that the effect of this credit balance standing on the account will be to charge against Profit and Loss Account the *expenditure*, not the *payments* in the ensuing half-year.

Second Method. The second method is as follows:—

Carriage Account.

Dr.			*Cr.*		
Sept. 10.	To Cash .	. £14 3 6	Dec. 31.	By Profit and Loss Account	£38 5 6
Dec. 13.	" " .	. 16 15 9			
" 31.	" Accounts outstanding .	7 6 3			
		£38 5 6			£38 5 6

Accounts Outstanding Account.

Dr.			*Cr.*		
			Dec. 31.	By Carriage	. £7 6 3

The outstanding item of £7, 6s. 3d. is in this illustration debited to the Carriage Account, thus giving us the correct charge to Profit and Loss Account for the period, and it is then credited to an account designated Accounts Outstanding. Other unpaid charges would be similarly treated, so that the Accounts Outstanding Account would have at its credit all of such items, and the total of them would therefore be included in the Balance Sheet as one liability. When the books are to be opened for the new period, Accounts Outstanding Account

would be debited with the several items, and the appropriate Nominal Accounts would be credited. For example, the above item of £7, 6s. 3d. would be debited to Accounts Outstanding Account as "Jan. 1. To Carriage," and Carriage Account would be credited "Jan. 1. By Accounts Outstanding." The result of this opening transfer is to leave the Nominal Accounts in the same position as they would have been in had there been no intervention of the Accounts Outstanding Account. The only practical benefit of this Outstandings Account is to group under one head the various unpaid charges, thereby simplifying their inclusion in the Balance Sheet.

Third Method. The third method is to open personal accounts for the parties to whom the debt has been incurred, and to enter therein the amount of the outstanding debt, thus—

Carriage Account.

Dr.			*Cr.*		
Sept. 10.	To Cash .	. £14 3 6	Dec. 31.	By Profit and Loss Account	£38 5 6
Dec. 13.	" " .	. 16 15 9			
" 31.	" A B .	. 7 6 3			
		£38 5 6			£38 5 6

Carriage Account is here shown Dr. to A B for the £7, 6s. 3d. outstanding at 31st December, and A B's account would be credited with the same sum, thus giving the double entry. The great objection to this method of treatment is that the payment ultimately made may be of a larger sum, of which the £7, 6s. 3d. was but a part, the remainder being new items; and it would then be necessary to post the cash payment in two parts, the £7, 6s. 3d. to A B's account, and the new items to the current Carriage Account.

Of the three methods discussed, the first is preferable to the others, any disadvantage attaching to it being easily surmountable.

Unexpired Expenditure. With regard to the unexpired expenditure, that is, the proportion of paid charges which effeirs to the new financial year, it is only necessary to give one illustration to bring out the principle of treatment. Take the Insurance Account—

Insurance Account.

Dr.			Cr.		
Sept. 30.	To Cash .	. £20 0 0	Dec. 31.	By Profit and Loss Account	£5 0 0
				" Balance (unexpired) .	15 0 0
		£20 0 0			£20 0 0
Jan. 1.	To Balance	. £15 0 0			

The student will first notice that the unexpired portion of the premium is credited to the old period's account and debited to the new period, just as the stock on hand was treated. In the example taken it has been supposed that a payment of £20 was made on 30th September to insure against a specified risk for one year. The books close on 31st December, and only one-fourth of the period covered by the insurance has then elapsed. Obviously the charge to the Profit and Loss Account for that three months' insurance is £5, and it is equally evident that £15 of benefit is still to be reaped in the ensuing nine months. Of the £20 paid, then, £5 must be written off to Profit and Loss Account at 31st December, and the balance of £15 must be carried down to the debit of the period which is to get the benefit of that portion of the outlay.

Much of the student's difficulty in this part of the work arises from the want of a practical knowledge of a general character, for instance, in ascertaining the proportion of rent which has accrued to the date of the Balance Sheet he must have the terms of payment and occupancy at his finger-ends. Likewise he must not be unfamiliar with the periods covered by the different assessments levied by the local authorities. The principal points to be remembered in these connections are therefore given here. First, there are the terms of occupancy of premises. In Scotland the removal terms are 28th May (Whitsunday) and 28th November (Martinmas). When calculating the proportion of rent which should be taken in as accrued to the date of a Balance Sheet these dates should invariably be used, as the profit was earned during the occupation of the premises and the charge must accordingly be levied on the business according to the period of occupancy.

Accruing Rent.

The rents of premises in Scotland are commonly payable half-yearly at 15th May (Whitsunday) and 11th November (Martinmas), these payments, unless otherwise contracted for by the lease, being in payment of tenancy for the half-year from the preceding removal term to the following one. Thus, rent paid on 15th May is for occupation from 28th November preceding to 28th May then current. Legal apportionment is quite another matter, and what the business man in his accounting must aim at is to charge against his profits for each period the whole expenditure incurred during that period in earning such profits, and no more. To take an example. We are balancing our books on 31st December, and find that we last paid rent on 11th November, and that that payment was for the half-year from Whitsunday to Martinmas. Now, that payment entitled us to possession to 28th November notwithstanding that it was made on 11th November. The amount outstanding at 31st December is therefore from 28th November to 31st December = 33 days' proportion. For a Balance Sheet at 30th June the proportion would be from the Whitsunday removal term (28th May) to 30th June.

Insurances.

The insurance premiums are always paid in advance, and, while the premiums for employers' liability and similar risks fall due on the anniversary of the risk attaching, fire renewals usually fall due on the quarter days Candlemas (2nd Feb.), Lady Day (25th March), Whitsunday (15th May), Midsummer (24th June), Lammas (1st August), Michaelmas (29th Sept.), Martinmas (11th Nov.), and Christmas (25th Dec.) The amount to be carried down as unexpired will be the proportion effeiring to the period from the date of the Balance Sheet to the next renewal term.

Rates and Taxes.

The Rates present greater difficulty on account of their variety and different due dates. In Scotland the Poor and School Rates are payable for the year from Whitsunday to Whitsunday, and similarly with the local rates, whether a county consolidated rate or a burgh assessment. A point to be observed is that these rates are ordinarily payable some time between November and February, and if we balance our books at 31st December they may either be wholly unpaid or wholly paid.

If unpaid, we must debit Rates and Taxes Account with the proportion for the period from 28th May to 31st December, and this sum would be taken in as a liability in our Balance Sheet. If the rates were paid prior to 31st December we would have to credit the account with the proportion applicable to the period from 31st December to 28th May following, and this sum would be carried down to the Dr. of the new period's account and be included as an asset in our Balance Sheet. Should the rates be partly paid and partly unpaid, only the difference between the proportion paid in advance and that accrued due would be passed through the books.

When the Property Tax is paid by the trader tenant he is entitled to deduct it on next paying rent to his landlord, usually at the following Whitsunday term. If this tax be paid before the closing of the books it must not of course be apportioned over the period like the tenant's rates; it is wholly recoverable from the landlord, and must therefore be treated as a part payment of the rent falling due at the following term.

It will be observed that in apportioning the rates the 28th May (the removal term) has been given, not the 15th (the legal term); this is because the rates are "in respect of occupancy," and the charge must be levied against the profits earned during such occupancy.

Discounts, and Provision for Outstanding Discounts.

Discount Transactions.

The student should now have a good grasp of the method of treatment of discounts granted by us to debtors and to us by creditors. These transactions involve an entry in the Discount Account and another in the personal account either of the debtor making the payment or of the creditor to whom the payment is being made. The simplest view of the transaction is to consider whether discount is lost or gained, and debit or credit Discount Account accordingly. If Discount Account be credited, the personal account must be debited; and if Discount be Dr., the personal account must

be Cr. Then, again, discount transactions invariably occur simultaneously with cash transactions. When a debtor pays us his account we receive cash, and allow him discount, and these two items together make up the amount of the debt being settled. Cash received is Dr. in Cash Account, for cash *comes in*, and discount allowed by us is Dr. in Discount Account for the *loss*, and the customer is Cr. for both items together. Discount transactions would, therefore, always appear in the Journal in one of the following forms, according as the account is payable or receivable by us:—

Creditor's personal account Dr.
  To Cash, for the net sum paid
  ,, Discount, for the discount allowed by him.

Cash, for net sum received Dr.
Discount, for discount allowed to him. ,,
  To Debtor's personal account.

In other words, cash and discount are invariably both Dr. or both Cr. in the transaction, and the personal account concerned has the sum of the two items at its Cr. or Dr., as the case may be. This is an infallible guide in the treatment of discounts.

Provision for Customers' Discounts.

When a set of books is being balanced at the close of a financial period there are usually debts outstanding due to the business, and it is admitted that when these debts come to be paid during the new financial year discounts will have to be allowed thereon. It would manifestly be unfair to leave all these discounts to be charged against the Discounts Account of the new period while taking credit in the old year for the profits earned on the transactions originating the debts on which they are to be allowed, that is, although the discounts have not been allowed to the debtors up to the date of the Balance Sheet simply because the debts have not been settled up to that date, it is only equitable between the old financial year and the new to make provision out of the profits of the old year for these

discounts which fall to be allowed on the debts incurred to the business in its course. This provision is commonly made by way of percentage on the outstanding accounts. The way to pass such an item through the books is to debit the old year's Discount Account and credit the new year's Discount Account, just as was done in the other nominal accounts with expenditure incurred but unpaid. The Dr. entry in the old account has the effect of charging the item to the old year's Profit and Loss Account, and the Cr. entry in the new account necessitates its being included in the Balance Sheet, when the books close, *as a liability*, but it is more correct to show this item deducted from the asset "Book Debts." This method brings out Book Debts at the net sum estimated as receivable, that is, the gross sum standing at the Dr. of the customers' accounts, minus the "Provision for Debtors' Discounts," as it is termed. If there be a Bad Debt Reserve on the books in addition to this Provision for Debtors' Discounts, theoretically the former should be deducted from the Book Debts before the estimated percentage for the latter is calculated. This is because no provision need be made for discounts on the proportion of the Book Debts regarded as contingently bad. As a matter of practice, however, both provisions are calculated on the gross book debts and their sum shown deducted in the Balance Sheet.

Creditors' Discounts Outstanding.

Discounts may also be outstanding on the accounts due to creditors at the date of the Balance Sheet. The old year must get credit for such discounts estimated as receivable, and accordingly the entry is, Credit the old year's Discount Account and carry the item down to the debit of the new year's account. The effect of this entry is to increase the expiring year's profit, and to show the item as a Dr. balance on the books when the Balance Sheet is prepared. This Dr. balance would therefore have to be taken in as an asset, or, more correctly, be deducted from the liability "Creditors' Accounts," the net amount of which would then be carried out as the liability payable.

Where only one account is kept for both customers' and creditors' discounts, the outstanding discounts would be shown on the account, thus:—

Dr. *Discount Account.* *Cr.*

		CB						CB			
July 31.	To Discounts for month . .	61	£3	9	4	July 31.	By Discounts for month . .	61	£2	14	6
Aug. 31.	„ Do. .	76	4	6	7	Aug. 31.	„ Do. .	76	1	0	3
Nov. 30.	„ Do. .	126	2	11	9	Oct. 31.	„ Do. .	108	0	18	4
Dec. 31.	„ Do. .	150	7	15	3	Dec. 31.	„ Do. .	150	6	3	2
	„ Balance, being 1 per cent. on Book Debts . .		5	13	4		„ Balance, being 2½ per cent. on Creditors' Accounts .		2	17	6
							„ Profit and Loss Account .	GL 81	10	2	6
			£23	16	3				£23	16	3
Jan. 1.	To Balance (estimated Creditors' Discounts)		£2	17	6	Jan. 1.	By Balance (estimated Debtors' Discounts)		£5	13	4

Bad Debts and Bad Debt Reserve.

Bad Debts.

It frequently happens that customers who have been purchasing from us on credit fail to meet their debts. In such cases we cannot allow the balances due by them to stand against them in our books indefinitely; these balances must be written off—disposed of finally if they cannot be collected. When any sum stands in our Ledger against a customer whom we have reason to believe will never pay the debt, we regard the debt as irrecoverable, and term it a "Bad Debt." The only way to purge our books of such items is to credit the account of the defaulting debtor, thereby squaring it, and debit a nominal account called "Bad Debts Account." This Bad Debts Account being a nominal account is closed when balancing the books, by transferring its balance to Profit and Loss Account. The result of writing off customers' accounts as Bad Debts, then, is to charge our Profit and Loss Account with the amounts, thereby reducing our net profit. Occasionally whole or part of certain of these written-off debts is recovered, in which case the amounts received should be posted to the Cr. of "Bad Debts Account," thereby reducing the current period's loss on bad debts.

When preparing our Balance Sheet we find among our

assets Customers' Accounts amounting in the aggregate to a large sum. Our experience suggests at once that a part of that sum will eventually turn out to be irrecoverable. We cannot identify these doubtful items yet; we may have no reason to regard any particular balance as doubtful, still we regard it as only prudent to provide against the contingency. The usual method is to charge against profits a percentage on the whole book debts outstanding. The entry would be, debit the old year's Bad Debts Account and credit the new account, just as was done with the Provision for Customers' Discounts. The effect of the entries is to charge the loss to Bad Debts Account, and through it the Profit and Loss Account, and to show the amount at the credit of the new account to be taken in as a liability or deducted from the asset "Book Debts." Some prefer to credit the amount to a Bad Debts Reserve Account instead of carrying the sum down like a balance, but with a reserve based as a percentage on the fluctuating amount of customers' accounts, adjusting entries between the Bad Debts Account and the Bad Debts Reserve Account are required at every balance. The Bad Debts Account would appear thus, were the bad debt reserve balance carried down on it—

Bad Debt Reserve.

Bad Debts Account.

Dr.							*Cr.*						
Dec. 31.	To E F	14	£2	1	9		July 1.	By Balance, being Reserve of 2 per cent. on £520, 12s. 6d. . .		£10	8	3
	„ G H	36	0	10	6		Nov. 11.	„ Cash C D, now recovered	114	1	9	2
	„ M N	79	4	13	1		Dec. 31.	„ Profit and Loss GL Account . .	81	15	19	3
	„ S T	92	9	4	8							
	„ Balance, being 2 per cent. on £566, 13s. 4d.		11	6	8							
			£27	16	8					£27	16	8
							Jan. 1.	By Balance, being Reserve of 2 per cent. on £566, 13s. 4d. . .		£11	6	8

It will be seen in the foregoing example that the floating reserve of 2 per cent. on the customers' accounts has increased during the half-year because the outstanding debts have

risen, and the whole loss, actual and contingent, on Bad Debts Account, is transferred to Profit and Loss Account in one entry.

Depreciation.

There is still one item calling for consideration before the true profit for the period can be ascertained and stated in the Profit and Loss Account, viz. depreciation. We shall confine ourselves strictly to the matter as met with in the simplest case of a trading concern, reserving the more complex considerations to be dealt with in the chapter on Manufacturers' Accounting. In the course of business the trader utilises his fittings and fixtures, movable plant, and trade utensils of various descriptions. These assets all deteriorate by use and the lapse of time, and as such depreciation is due to their being employed in the conduct of the trade the charge for the depreciation is a proper expense of the business, and falls to be debited to the Profit and Loss Account for the period during which such depreciation takes place. The book entry for depreciation is, debit Depreciation Account (or the Profit and Loss Account directly if there be only one item to provide for) and credit the Plant and Fittings Account. The effect of this entry is to charge the profit with the amount being written off and to carry down on the Plant Account the reduced or depreciated value of the asset.

It is in fixing the amount to be written off that the real difficulty emerges however, and we have now to look at the considerations which affect this question. The Inland Revenue authorities in relation to income tax assessment point out that there is no statutory provision for allowing depreciation on shop fittings and furnishings but that the tax-payer is entitled to charge against revenue his yearly outlay on replacement of worn-out items. To follow such a course might entail a very heavy charge in one year and a very light charge the next, so that the yearly charges by that method would bear no relation to the actual wastage of the year. Where the outlay on renewals is steady this plan may be adopted, as it has the advantage of simplicity. In ordinary cases the renewals would be so irregular that some method of averaging the depreciation charge must be fixed, and it is almost the invariable practice in

trading concerns to add to the Plant Account all outlays for renewals when they are made, and to write off a fixed percentage from the Plant Account annually. It will be seen that this method cannot claim to be mathematically accurate, because, as the percentage is written off what is termed the "written-down value," no asset is ever fully written off the books; but when this method is employed it will be found that an otherwise unnecessarily heavy percentage is written off which to some extent compensates for the inaccuracy. Whatever may be the influences affecting any particular case under consideration, the fixed principles to be kept in view are (1) that the depreciation written off for the period should represent the wastage of the asset in the course of that period's trade, and (2) that the written-down value of the asset should be its approximate value to the business as a going concern.

Petty Cash.

Petty Cash Book.

In large businesses it is usually undesirable to have the small cash payments of a miscellaneous nature entered in detail through the principal cash book; to avoid this it is necessary to have a subsidiary cash book which is commonly known by the name of the "Petty Cash Book." This petty cash book is frequently in the keeping of one of the junior clerks, but it may be kept by the cashier himself. The petty cash book provided for the record of his payments is most conveniently kept on the columnar system, and the following is suggested as a suitable form for an ordinary commercial house:—

Received.	Date.	Item.	Paid.	Postage and Receipt Stamps.	Carriages.	Office Sundries.	Petty Travelling Expenses.	Cleaning.	General Charges.

Imprest System.

The following system is commonly known as the "Imprest System." At the institution of such a system the cashier pays over to the petty cash-keeper a sum slightly in excess of the estimated requirements for the ensuing month. This amount is entered in the principal cash book as "Paid to Petty Cash," and the Cr. entry in the cash book is posted to the Dr. of the Petty Cash Account in the general ledger. The petty cash-keeper enters the amount so received by him in the Dr. column of his cash book. As the petty cash payments are made in the ordinary course of business they are entered on the Cr. side of the petty cash book and extended to their appropriate analytical columns. At the end of the month the petty cash book Dr. and Cr. columns are balanced, when the balance carried down should agree with the amount of cash actually carried forward to the new month. At the same time the analytical columns in the petty cash book are summed, and their aggregate necessarily agrees with the total disbursements during the month just closed. The cashier then passes through the principal cash book the disbursements for the month, keeping them analysed under their several heads, crediting the amounts in his cash book, and from thence posting the items to their appropriate nominal accounts in the general ledger. He then pays over to the petty cash-keeper the exact amount of the disbursements which he had thus credited in his cash book. When the petty cash-keeper receives this amount from the cashier it brings up his cash balance to the sum with which he originally began, and the process is repeated month by month. The balance on the Petty Cash Account in the general ledger stands unaltered, because the sum to be accounted for by the petty cash-keeper is always at the original figure, *i.e.* the amount of petty cash in hand plus the disbursements for the current month must amount to the sum standing at the Dr. of the Petty Cash Account. Instead of detailing each month's disbursements in the principal cash book and posting from such detailed entry to the expense accounts, the cash book entry may be "By Petty Cash Disbursements for month," the total only being credited to cash; the expense account postings are then made from the Petty Cash Book column totals direct.

The cash book entry would be folioed "P. C. B." (Petty Cash Book), and the expense account ledger folios would be placed under their respective totals in the petty cash book.

Alternative Method. The alternative system is for the cashier to pay over to the petty cash-keeper such sums as may be required from time to time. Such sums are credited in the principal cash book and posted from there to the Dr. of Petty Cash Account. Periodically the petty cash book is balanced, and a journal entry is then made debiting the several nominal accounts with their respective amounts and crediting Petty Cash Account with the aggregate. The balance on the Petty Cash Account from time to time represents the sum still to be accounted for by the petty cash-keeper, and agrees with the Dr. balance carried down on the petty cash book as representing his petty cash on hand.

Review of Modern Practice.

Having now discussed in detail the several books used in a commercial house in actual business, it is expedient for the student to recapitulate the steps through the whole system towards the final Balance Sheet.

1. If the books are being opened for a new business the first transaction will be the capital put into the concern; but if the business has previously been carried on, a Balance Sheet as at the opening date must be prepared showing the assets and liabilities (including capital) as at that date. The opening entries for the books are the items in this Balance Sheet, and they should be journalised in the manner shown, the assets being debited and the liabilities credited to their appropriate accounts. The cash on hand and cash in bank will be posted from the Journal to the Cash Book, as the Cash and Bank columns therein take the place of Ledger accounts. The postings of these opening entries would be made from the Journal as "To Balance" and "By Balance" respectively.

2. The transactions would be passed through the various books of original entry and posted thus—

(1) Cash Book—every debit is credited to some Ledger Account, and every credit is debited to some Ledger Account (pay-ins to bank and cheques cashed excepted—both debit and credit of such entries are in the Cash Book).

(2) Invoice Book—items are credited to sellers, and monthly total is debited to Purchases Account.

(3) Returns Outwards Book—items are debited to sellers to whom returned, and monthly total is credited to Purchases Account.

(4) Day Book—items are debited to customers, and monthly total is credited to Sales Account.

(5) Returns Inwards Book—items are credited to customers by whom returned, and monthly total is debited to Sales Account.

(6) Bills Receivable — items are credited to givers, and monthly total is debited to Bills Receivable Account.

(7) Bills Payable — items are debited to drawers, and monthly total is credited to Bills Payable Account.

3. The Trial Balance is now taken off to verify the postings.

4. The closing entries are now made in the following order, the Journal being used :—

(1) Balances on Purchases and Sales Accounts to be transferred to Goods Account, also Cash Sales and Cash Purchases Accounts to be closed into Goods Account.

(2) Stock on hand to be valued and amount passed through the Goods Account.

(3) Outstandings to be passed through their appropriate Nominal Accounts, thereafter the Nominal Accounts to be closed into Profit and Loss Account, and also Gross Profit from Goods Account.

(4) Net Profit to be transferred from Profit and Loss Account to Capital Account.

(5) The Personal and Real Accounts to be balanced without the use of the Journal, the balances being carried down.

(6) Balance Sheet as at closing date to be prepared—all Dr. balances still on the books are Assets, and all Cr. balances are Liabilities; the two sides must agree in their sum.

III.—BALANCING METHODS

One of the outstanding advantages of Double Entry book-keeping is the check on the arithmetical accuracy of the records by the agreement of the aggregate debits and credits in the Trial Balance. The numerous postings and castings in a series of transactions make the attainment of this agreement of debits and credits difficult, and the calling over of the postings and checking of the castings to find the errors occasioning the difference are tedious processes involving loss of time and consequent interference with the proper counting-house routine. Various methods have been devised with the object either of preventing errors or of localising them and thus leading to their early rectification. Of these methods the best known are:—

1. Agreement of Trial Balance totals with the Journal totals;
2. Sectional Balancing;
3. Check numbers.

We shall consider these individually.

The Agreement of Trial Balance Totals with the Journal Totals.

The Trial Balance may be either a list of ledger balances arranged as debits and credits, or a list of the debit and credit postings in the ledger; the former contains only the excess debits or credits on each account, the latter contains the sum of both sides of each ledger account. The Journal has two cash columns appropriated respectively to the debit postings and the credit postings. It is not now the custom to journalise every entry before posting, but we may pass through the journal the periodical totals of the books of original entry, and, as these books of original entry contain all the items posted to the ledger, it is clear that the sum of the journal must equal the sum of the period's postings. If, then, the opening entries be also journalised and the Trial Balance be taken off in the second form—total debits and total credits on every ledger account—the two Trial Balance

totals must agree with the two Journal totals. In the event of the Trial Balance columns disagreeing, a comparison of the totals with the corresponding Journal totals would reveal which side of the Trial Balance was in error, and the search for the error could then be restricted to the entries on that side. This is the extent of the benefit to be derived from this Balancing Method—the error is localised to debit or credit side of the Trial Balance. The only difficulty which the student might experience in carrying through such a system of check is in the framing of the Journal entries. The following skeleton entries will serve as a guide, assuming the use of the usual Cash Book, with Cash, Bank, and Discount columns, Invoice Book, Day Book, Returns Books, and Bill Books:—

Jan. 1.	Sundries, viz.:—	
	Goods Account	Dr.
	Plant	"
	Sundry Customers' Accounts	"
	Bank	"
	Cash	"
	being Assets at this date.	
	To Sundries, viz.:—	
	Sundry Creditors' Accounts	
	Bad Debts Reserve Account	
	Capital Account	
	being Liabilities at this date.	

Note.—No postings are required for these items, as the several balances already stand on their respective ledger accounts (the cash and bank balances in the Cash Book). The sole object of this entry is to incorporate in the Journal totals the amount of the opening entries already in the Ledger, so as to effect the agreement of Journal totals with Trial Balance totals.

Jan. 31.	Purchases Account for Invoices	Dr.
	Sales Account for Returns Inwards	"
	Bills Receivable A/c for Bills received	"
	Discount Account for Dr. discounts	"
	To Sundry Personal Accounts	
	for month's transactions already credited from the books of original entry.	

NOTE.—Purchases, Sales, Bills Receivable, and Discount Accounts would be debited from the foregoing entries. There is no credit posting from this entry, as the Sundry Personal Accounts concerned have already been credited from the books of original entry.

Sundry Personal Accounts Dr.
To Sales Account for Sales
„ Purchases Account for Returns Outwards
„ Bills Payable A/c for Bills granted
„ Discount Account for Cr. discounts
for month's transactions already debited from the books of original entry.

NOTE.—All these credit entries would be posted to their respective ledger accounts. The Sundry Personal Accounts have been individually debited from the books of original entry, and this aggregate debit therefore requires no posting.

Sundry Accounts Dr.
To Cash for Cash payments
„ Bank for Cheque payments
for credits in Cash Book already debited from the Cash Book.
Cash for Cash receipts Dr.
Bank for pay-ins „
To Sundry Accounts
for debits in Cash Book already credited from the Cash Book.

NOTE.—These Cash and Bank items would be carried to Ledger Accounts, which would be summaries containing only the opening Cash and Bank balances and the monthly totals posted from these Journal Entries.

Such entries would be journalised monthly, and the Journal summations would be carried on throughout the year so as to produce the required aggregate of the postings at the close. In dealing with the Ledger it is frequently found laborious to carry on every account throughout the year as is necessary for this method, especially the Customers' accounts which may be rendered and settled at intervals throughout the year. To minimise this inconvenience it is recommended that the Dr.

side of the Customers' Ledger be provided with two Cash columns, the inner column for the individual debits and the outer column for the extension of the month's or quarter's debits (according to the periods of rendering the accounts). In this way these periodical extensions would be readily seen to be settled by the credits of cash, and the amounts of the current period's debt would stand out distinctly. At the close of the financial year every account which had been open at any time during the year would have its total debit and total credit included in the Trial Balance, and as all the items appearing in the Ledger accounts have been summarised in the Journal, the Trial Balance totals must agree with their corresponding Journal totals as well as have the debits and credits in agreement.

Special Ledger Ruling.

SECTIONAL BALANCING.

The foregoing method of localising the errors in a Trial Balance reveals merely the side—Dr. or Cr.—on which the under- or over-statement occurs. In a concern doing a large business this information as to which side is in error is not sufficient; some clearer indication is required as to which section of the work should be examined for the mistake in the certainty of finding it with a minimum expenditure of time. The most effective guide recognised by book-keepers is the self-balancing ledger, that is, a ledger which balances independently of the other books of the system. The advantage of this method is that any error which exists is localised to a particular ledger. It is possible to verify the ledgers separately, and only the one which fails to balance need be checked or scrutinised for the amount of the difference.

The ledger accounts of a business are ordinarily grouped into divisions, the main classes commonly being customers' accounts, creditors' accounts, and the real and nominal accounts. The first of these is kept in the Customers' or Sales Ledger, the second in the Creditors' or Bought Ledger, and the third class in the General Ledger. Assuming then the existence of these three ledgers—the classes might be subdivided without interfering with the general principles now to be laid down—one other essential is a columnar cash book. The form of this cash book is as follows:—

Division of Ledger Accounts.

Dr.													Cr.
General Ledger.	Customers' Ledger.	Folio.	Discount.	Bank.	Cash.	Date.	Item.	Cash.	Bank.	Discount.	Folio.	Cr'ditors' Ledger.	General Ledger.

The Cash, Bank, and Discount columns in the above ruling are used as previously explained when treating of cash books, and the only new features in this form are therefore the columns relating to the divisions of the ledger accounts. All cash received from a customer is debited in the cash book and any discount allowed on the transaction is extended to the column, and the amount being settled is entered in the Discount Customers' Ledger column on the same line. The customer has to be credited with the amount so settled as appearing in the Customers' Ledger column. Cash sales should be treated through the Customers' Ledger column and a Cash Sales Account opened for them in that ledger. Such account might be closed by passing a Day Book entry through periodically and posting such from the Day Book to the Dr. of this Cash Sales Account, or by treating the Cash Sales total separately in the General Ledger Account. Every item appearing in the Customers' Ledger column in this cash book would thus be credited to some account in the Customers' Ledger, and clearly the total of the Customers' Ledger column would represent the total postings from the Cash Book to the credit of the accounts in the Customers' Ledger. A customer's account has at its Dr. the balance at the beginning of the year and the goods sold to him during the year, as posted

Balancing Sales Ledger.

from the Day Book, and at its Cr. the cash received from that customer and the discount allowed to him, as posted from the Cash Book as already explained. If we could treat the customers' accounts in the aggregate by utilising the Day-Book totals, the Cash-Book column totals for Customers' Ledger, and the list of balances at the beginning, we would certainly bring out a sum which would represent the aggregate of the balances due by all the customers at the end of the year. This is done by opening within the customers' ledger itself an account called "General Ledger Account"; it is so called because the counterpart of the entries appearing throughout the Customers' Ledger is to be found in the accounts contained in the General Ledger. Thus, in the Customers' Ledger the customers' accounts are Dr. at the beginning of the year for the balances due by them, so if in the proposed General Ledger Account we credit the total of such balances, the sum of the debits and credits within the Ledger would agree. Likewise the sales to the customers from day to day are posted to their Dr. from the Day Book, so if we credit the total of this Day Book to the General Ledger Account the equality of debits and credits is still maintained. Then the separate cash and discount items appearing in the "Customers' Ledger" column of the Cash Book are credited from there to the individual customers concerned in the transactions, so if we debit the totals of that column to this General Ledger Account the equilibrium of the ledger is still undisturbed. Finally, if we prepare a list of the balances owing to us by those customers at the close of the year, the total of such list must necessarily agree with the balance shown on this General Ledger Account. In other words, the General Ledger Account shows in periodical total (and on the opposite side) the transactions which are separately debited or credited to the individual customers' accounts, and therefore the sum of the customers' Dr. balances must agree with the Cr. balance on the General Ledger Account. There are frequently entries of a different nature from these instanced above, and those must be provided for in the same way. For example, all bad debts are written off by crediting the account of the defaulting customer and debiting Bad Debts Account. The simplest way to deal with these items is to keep a Bad Debts Account in the Customers' Ledger, to the Dr. of which such items would be

transferred. At the time of balancing the books this Bad Debts Account would be squared by crediting it with the amount of its balance and debiting the like sum to General Ledger Account.

Bills Receivable.

In the case of bills receivable, as the bills are separately credited to the customers granting them, the total of the Bills Receivable Book has to be debited to the General Ledger Account so as to maintain the balance of the Customers' Ledger independently. An alternative method of dealing with the bills receivable is to keep the Bills Receivable Account in the Customers' Ledger, in which case the individual bills would be found credited to the granters' accounts and the monthly total debited to this Bills Receivable Account; both Dr. and Cr. are then within the compass of the one ledger and no General Ledger Account entry is necessary. The cash received for these bills would in this case be extended to the Customers' Ledger column of the Cash Book. The former method is the preferable and perhaps the more generally followed. The General Ledger Account to be kept in the Customers' Ledger then appears thus—

General Ledger Account.

(Kept in the Customers' Ledger.)

Jan. 31.	To Cash and Discount postings from Cash Book, per Customers' Ledger column total.	Jan. 1.	By Amount of Customers' balances at this date, per List.
	„ Returns Inwards for month, per Returns Inwards Book.	31.	„ Sales for month, per Day Book.
	„ Bills Receivable granted by customers during month.	Feb. 28.	„ „ „
	(and so on for each month).		(and so on for each month).
Dec. 31.	„ Bad Debts Account for accounts written off during year.		
	„ Balance on this account carried down, agreeing with the total of customers' balances per List.		
		Jan. 1.	By Balance brought down.

The Creditors' Ledger would be made self-balancing on the same principle. The separate creditors' accounts open the year by standing Cr. for the balances due, and they are further

credited during the year with the purchases made, and they are debited with the cash and discount from the Cash Book.

Balancing Bought Ledger.

All these transactions are found grouped in some of the books of original entry and it is therefore possible to frame a summary of them. This summary takes the form of a General Ledger Account which is kept within the Creditors' Ledger itself so as to make it balance independently of the other books. This General Ledger Account is made Dr. at the beginning of the year for the total of the balances owing to the creditors as brought out in the list prepared as at that date, and as these separate balances individually stand at the Cr. of their respective personal accounts, the debits and credits on this ledger then agree in their amount. The separate purchases from the wholesale houses are credited to the personal accounts from the Invoice Book, and the total of this Invoice Book is therefore debited in the General Ledger Account, thus preserving the balance of the ledger. Then, as the cash payments to and discount allowed by those creditors are passed through "Creditors' Ledger" column of the Cash Book, and are posted from there to the Dr. of the personal accounts, the monthly total of that column is credited to the General Ledger Account.

Bills Payable.

The bills payable granted to the creditors are debited to their personal accounts from the Bills Payable Book, and the monthly total of that book should accordingly be credited to the General Ledger Account. An alternative method of dealing with the bills payable is to keep the Bills Payable Account in the Creditors' Ledger. As the individual bills would then be found debited to the receivers' accounts and the monthly total credited in this Bills Payable Account, both Dr. and Cr. then being within the compass of one ledger, no General Ledger Account entry would be necessary. In this case the payments of the bills would be extended to the Creditors' Ledger Cash-Book column instead of to the General Ledger column as under the former method. The former method of keeping the Bills Payable Account within the General Ledger is preferable and more generally followed. Cash purchases should be passed through the "Creditors' Ledger" column in the Cash Book and posted from there to the Dr. of a Cash Purchases Account in the Creditors' Ledger. Periodically this account might be closed

by passing an entry through the Invoice Book for the amount necessary to square it and posting such entry to the Dr. of such Cash Purchases Account, or by treating the cash purchases totals separately in the General Ledger Account. At the close of the year a list of balances standing on the creditors' accounts is prepared, and the total of this list should agree with the balance shown on the General Ledger Account. The balances on the creditors' accounts are of course Cr. balances, while the General Ledger Account balance is in this case a Dr., and the ledger is thus self-balancing. The General Ledger Account in the Creditors' Ledger appears as follows:—

General Ledger Account.

(Kept in the Creditors' Ledger.)

Dr.		*Cr.*	
Jan. 1.	To Amount of Creditors' balances at this date credited to the separate personal accounts, per List.	Jan. 31.	By Cash paid and Discount allowed during month, per Creditors' Ledger column in Cash Book.
31.	„ Purchases for month, per Invoice Book.		„ Returns Outwards for month, per Returns Outwards Book.
Feb. 28.	„ „ „ (and so on for each month).		„ Bills Payable granted during the month, per Bills Payable Book. (and so on for each month).
		Dec. 31.	„ Balance on this account carried down, agreeing with the sum of the balances owing to creditors at this date, per List.
Jan. 1.	To Balance brought down.		

Balancing General Ledger.

The General Ledger contains all the nominal and real accounts connected with the business. The only other class of accounts is the personal accounts, which are assumed to be divided into two groups—the customers' and the creditors'. These two groups have separate ledgers provided for them, and these have been made self-balancing, as demonstrated above. To make the General Ledger self-balancing we must embody in it a summary of these two classes of personal accounts, and this is most readily done by opening two accounts in the General Ledger, one called " Customers' Ledger Account " and the other " Creditors' Ledger Account." These accounts contain at their debit and credit respectively a summary of the items

which appear in the separate ledgers. Thus, the Customers' Ledger Account is Dr. for the amount due by the customers at the beginning of the year and the sales to them during the year, and it is Cr. for the cash and discount monthly totals from the Customers' Ledger column in the Cash Book, for the bills receivable granted by the customers, and also for the bad debts written off; in fact, this Customers' Ledger Account in the General Ledger is exactly the same as the General Ledger Account kept in the Customers' Ledger, except that the items appear on opposite sides; the two accounts are the counterpart of each other. Similarly, the Creditors' Ledger Account is credited with the aggregate balances due at the opening of the year, and is credited further with the monthly totals of the purchases. It is debited with the monthly totals of the Creditors' Ledger column of the Cash Book, and with the monthly totals of the bills payable granted. The Cr. balance on this account should then agree with the sum of the Cr. balances on the creditors' personal accounts, and must also agree with the Dr. balance on the General Ledger Account in the Creditors' Ledger, of which this account is the counterpart. The only items which prevent the General Ledger from being complete in itself, like the Customers' and Creditors' Ledgers, is that the cash and bank balances as shown in the Cash Book must be taken into account in balancing it. This may be overcome by showing in the General Ledger an abstract or summary of the Cash Book, which abstract must of course close with the balances on hand and in bank carried down; or the Cash Book itself may be regarded as a part of the General Ledger and its closing balances taken into the balance without any Cash Book summary being prepared.

It will be seen that when a set of books has been kept on the lines just indicated the ledgers could be brought to a balance independent of each other and at any time to verify the postings. In the event of any of them failing to balance, it would then only be necessary to call over its postings and check its additions to discover the cause of the difference.

The Private Ledger.

The subject of the Private Ledger can most appropriately be dealt with as part of the larger subject of Sectional Balancing. It is generally desirable to keep the facts concerning the profits and capital of the business out of the ordinary General Ledger, so that the

office staff may not acquire this information and utilise it to the detriment of the firm. The only way in which this can be done is to keep a subsidiary General Ledger called the "Private Ledger," in which are kept the capital accounts of the partners, the Goods Account and Profit and Loss Account, and such other accounts as it is desired to keep private. In order that the public office set of books might balance independently of this Private Ledger, it is necessary to keep in the General Ledger a "Private Ledger Account." Any item which falls into the debit of an account in the Private Ledger is debited to the Private Ledger Account in the General Ledger instead, and likewise the credits for the accounts in the Private Ledger are credited to the Private Ledger Account in the General Ledger. The balances of the nominal accounts in the General Ledger are transferred to this Private Ledger Account at the time of balancing the books, because these balances fall to be debited or credited to the Goods Account and Profit and Loss Account which are kept in the Private Ledger.

One of the partners, or the confidential clerk, writes up the Private Journal from this Private Ledger Account in the General Ledger. The balances of the partners' Drawings Accounts, for instance, are journalised, debiting the individual Capital Accounts with the respective totals, and crediting a "General Ledger Account" which is kept in the Private Ledger; and all the nominal account balances falling to be passed through the Goods Account and Profit and Loss Account in the Private Ledger are debited to one of these accounts and credited to the General Ledger Account in the Private Ledger, or credited to one of these accounts and debited to the General Ledger Account. The balance of the Private Ledger Account kept in the General Ledger should agree with the balance of the General Ledger Account in the Private Ledger, but of course the balances will fall on opposite sides. It will thus be seen that the Private Ledger is self-balancing, and is totally independent of the other books, and that likewise the books in the public office can be balanced independently of the Private Ledger.

Check Numbers.

The two foregoing methods employed as aids to the balancing of a set of books have their advantages limited to

the localisation of the errors when a trial balance is made. The first method locates the error to the Dr. or Cr. side of the books, the second method locates it to a particular section of the Ledger accounts. This third method goes further than either of these others; it may be made to reveal the error, whether in the posting or in the summations, almost immediately it is made, and the wrong entry, the location of which is known to a page, can be seen by scrutiny alone. This method of check is based upon the theory of remainders, but it is not within our province to enlarge upon the arithmetical aspect of the matter; suffice it to say that these things are so and can be proved by application. Many numbers are in daily use as check numbers, and in different circumstances the same number can be differently applied. The odd numbers from 9 to 17 are those generally used, but 9 and 11 have such obvious limitations on account of their relationship to 10 that in practical work they may be discarded in favour of 13 or 17 applied in different ways. The general nature of the method may, however, be illustrated by a simple application of the number 11. The following items are supposed to represent the amounts on a page of a Day Book, and they are now to be posted to the customers' debit. One clerk calls off the items to another who has the Ledger. On debiting the amount to the Ledger account the clerk reckons the check number for the sum he has so debited, and he calls this number back to the clerk with the Day Book. This clerk inserts the check number in a special column of the Day Book at the same time as he folios the item. The Day-Book amounts and check numbers would then appear thus—

11 applied.

	Check No.			
	6	£3	16	9
	0	4	12	6
	7	10	8	11
	3	7	12	6
	10	21	16	6
	4	£48	7	2
3 x 3	9		(3)	
	2	=	2	

In applying 11 to £ s. d. the unit figures in the three columns are added (and the alternate figures to the left if the pounds

amount to three figures), and the sum of the tens' place figures (and the alternate figures to the left if the pounds amount to four figures), and the latter sum is deducted from the former. If this difference be less than 11, such difference is itself the check number; if the difference exceed 11, deduct 11 or its multiple, and the remainder is the check number—*e.g.* £431, 16s. 9d., we have $9+6+1+4=20$; and 0 (which is not, of course, ordinarily written, but is understood)$+1+3=4$; $20-4=16$; "cast out" 11, and the remainder 5 is the check number.

Then to turn to the foregoing application to Day Book posting, the first item gives us $9+6+3=18,—1$; net 17, cast out 11, check number 6: then $6+(2—1)+4=11=0$: next $(1—1)+8+(0—1)=7$: then $6+(2—1)+7=14$, less $11=3$: and finally $6+(6—1)+(1—2)=10$. The sum of the Check No. column is 26; cast out the nearest multiple of 11 (*i.e.* 22) and set down the remainder 4. The check number of this Day Book total is $2+7+(8—4)=13$, less $11=2$, but every 20 shillings in the summation of the items yields a check number of $20—11=9$, whereas, when stated as £1, the check number is only 1. We must accordingly deduct 8 (*i.e.* 9—1) from the Check No. column remainder for each completed £1 carried from the shillings column in the summation, but instead of *deducting* 8 we *add* $11—8=3$ (which has the same result) for each completed pound carried. In summing our page, then, we jot down the 3 we have carried from the shillings column to the pounds column, and to the Check No. column remainder 4 (already found) we add 3 times this carried 3, that is 9; $4+9=13$, cast out 11, giving 2 as our final figure, which agrees with the 2 already found for the total of £48, 7s. 2d. If any wrong amount had been posted the check number against it would have differed and shown a disagreement at the foot of the page, and if an omission had been made to post an item there would have been no check number against it, and again disagreement would have resulted (unless by coincidence the check number of the omitted item were 0). In either case a scrutiny of the amounts and corresponding check numbers on the page found to disagree would lead to the discovery of the misposting or omission and secure rectification. The number 11 has serious limitations which make it comparatively useless as a posting check number with

£ s. d., and we shall accordingly apply another number, 13, to a short series of supposed transactions stated in the most rudimentary form to illustrate the use of the check figure. **13 applied.** The method of application which we shall adopt is:—Take half the pounds (for an odd pound add 7) and add the shillings; from their sum deduct the pence (for ½d. add 7 to the pence before deducting); 13 or the nearest multiple thereof is cast out whenever convenient, and the resulting remainder is the check number. (It is usually easier to set the shillings against the pence, and the difference is then added to or deducted from the pounds figure)—

E.g. £57, 16s. 11d.; half the pounds plus 7 for the odd pound $=28+7=35$

Shillings minus pence = 5

40

Cast out nearest multiple of 13 = 39

Check number, 1

Again, £63, 4s. 9½d.; half pounds plus $7=31+7=38=12$

Shillings minus pence with 7 added to pence for ½d. $=4—(9+7)$ . . . . . $=—12$

Check number, 0

The shillings and pence in the last example give a minus to be deducted from the pounds figure. This minus can be converted into a plus by "borrowing" 13, thus giving a plus of 1; then 12 (the pounds figure)$+1=13$, cast out $13=0$, as before.

The supposed transactions are:—

A B puts cash into Bank to commence business . .	£500	0	0
He draws from Bank for cash	20	0	0
He buys goods from C on credit	60	10	0
He sells goods to D	24	14	9
And to E	15	5	10
He paid for Goodwill, Plant, and Fittings by cheque .	300	0	0
He pays C by cheque, less Discount £3, 2s. 6d. . .	60	10	0
He buys goods from C	124	7	9
He sells goods for cash	22	5	3
He pays into Bank	12	0	0
He pays Wages £7, 10s., and Trade Expenses, £15, 15s. 4d.	——		
He receives from D his cheque p. £24, 2s. 4d., Discount, 12s. 5d.	——		
He Banks	30	0	0

Cash Book.

	Fol.	Ck. No.	Discount.	Bank.	Cash.		Fol.	Ck. No.	Discount.	Bank.	Cash.
To Capital	1	3		£500 0 0	—	By Cash	—	10		£20 0 0	—
„ Bank	—	10		—	£20 0 0	„ Goodwill, &c.	3	7		300 0 0	—
„ Goods	2	0		—	22 5 3	„ C	—	1	£3 2 6	57 7 6	—
„ Cash	—	6		12 0 0	—	„ Bank	—	6		—	£12 0 0
„ D	5	4	£0 12 5	—	24 2 4	„ Wages	7	7		—	7 10 0
„ Cash	—	2		30 0 0	—	„ Trade Exps.	8	12		—	15 15 4
						„ Bank	—	2		—	30 0 0
						„ Balances	—	3		164 12 6	1 2 3
		12	£0 12 5	£542 0 0	£66 7 7			9	£3 2 6	£542 0 0	£66 7 7
To Balances		3	—	£164 12 6	£1 2 3						

NOTE.—The sum of Check No. column should yield the check number for the cross-sum of the cash columns. Thus for the Dr. side the three cash columns aggregate £609, 0s. 0d., of which the check figure is 12, agreeing with the remainder for the sum of the Check No. column; and for the Cr. side the three cash columns aggregate £611, 10s. 1d., of which the check figure is 9, agreeing with the remainder for the summation of the Check No. column.

Day Book.

	Fol.	Ck. No.	
D	5	4	£24 14 9
E	6	9	15 5 10
Goods Account Cr.	2	0	£40 0 7

(NOTE.—The sum of the Check No. column is 13=0; half 40=20, deduct pence, 7=13=0.)

Invoice Book.

	Fol.	Ck. No.	
C	4	1	£60 10 0
C	4	8	124 7 9
Goods Account Dr.	2	9	£184 17 9

(NOTE.—The sum of the Check No. column is 9; half 184=92, + (17—9)=100=9.)

Capital Account.

		By Cash	£500 0 0

Goods Account.

To Purchases per Inv. Book .	£184 17 9	By Cash . . .	£22 5 3
		„ Sales per Day Book	40 0 7

Goodwill, Plant and Fittings.

To Cash . . .	£300 0 0		

C's Account.

To Cash and Discount	£60 10 0	By Goods . . .	£60 10 0
		„ „ . . .	124 7 9

D's Account.

To Goods . .	£24 14 9	By Cash and Discount .	£24 14 9

E's Account.

To Goods . .	£15 5 10		

Wages Account.

To Cash . .	£7 10 0		

Trade Expenses Account.

To Cash . . .	£15 15 4		

The agreement of the Check No. column remainder with the check number for the cash-column total of each of the three books of original entry affords ground for strong presumption that the postings are correct, as the check numbers for the several items were taken on the sums actually posted to the Ledger. Any error which does exist is concealed by the check number for the wrong sum posted being the same as the check number for the correct sum—a coincidence not to be regarded as of likely occurrence. In the example given above the Ledger summations and balances could have been verified by inserting the check numbers in the Ledger also, in which case the remainders on the Check No. column on both Dr. and Cr. sides of the Ledger accounts would agree with one another and would also represent the check number on the totals. The check number on the balances would have to be inserted and carried down, as shown in the Cash Book in the example.

To assist in the reckoning of the check numbers, especially in dealing with large sums, a table of multiples of the check figure is useful. With very little practice such a system becomes easily worked, and its value, especially in checking Day Book postings and summations, amply compensates for the extra labour involved in the posting with the use of the system.

IV.—TRADERS' ACCOUNTING.

Business may be divided for accounting purposes into four classes, viz. commercial, industrial, financial, and professional. Commercial concerns purchase commodities and re-sell them at a profit; industrial concerns purchase materials, pay for labour spent upon them, and apply in the process plant and tools, all towards producing a different commodity which is sold at an advance on cost to yield a profit; financial concerns borrow on their own credit and lend at a higher rate of interest to reap a profit, or undertake financial obligations for a consideration; professional men give skilled services, valuable on account of the exercise of special knowledge, and receive fees or commission as their remuneration. The accounting of the last two classes is so specialised and necessarily varied with the nature of the business conducted that no study of their accounts can be advantageously undertaken within the scope of the present work.

In dealing with any one of these four classes it is well to keep clearly in view that the earning of profit is the object of the enterprise, and to devise an efficient yet simple system of accounting which will yield every information necessary to guide the management towards this object the source of the expected profit must be known. The accounting must then be arranged in such a way as to show, firstly, the emergence of the gross profit, which is the excess of the selling price over the cost price, and secondly, the various items or factors which tend to the increase and diminution of this gross profit resulting in the net profit.

Departmental Accounts.

The trader buys goods, usually in bulk or large quantities, and therefore buys cheaply, and he distributes these goods in

smaller quantities at such an advance in price as will cover his expenses in conducting this business of distribution, plus a margin for profit to compensate him for his management of the business, the use of his capital, and the risks of loss he undertakes in engaging in the trade. The elementary considerations discussed in the chapter on First Principles and Modern Practice kept this in view, but we have thus far only been supposing the case of a trader keeping his books in such a way as would enable him to answer the two queries with which we set out in the opening chapter, viz. what is his financial position at a given date, and what incomes and expenditures have contributed to effect the change since last he reviewed his position. Beyond this, or perhaps rather in order to answer more satisfactorily the latter of these queries, a trader may organise his business in two or more departments, and thus ascertain which class of trading is the more remunerative or whether each class pays its way. In other words, instead of being satisfied with one Goods Account showing the period's Gross Profit, the trader might desire to ascertain how such Gross Profit is distributed over the distinct classes of goods he deals in. It might be that he gains on one class of goods and loses on another, in which case the Gross Profit brought out on the Goods Account is the difference between such gain and loss. If he desire to locate his profits to different classes of goods he must keep those classes quite distinct in his books. We shall assume by way of illustration that a trader has conducted a business which turns over furnishings and drapery goods—a common combination—and he now desires to keep his accounts in such a way as to let him know whether and by how much he gains or loses on each of these two departments. The items in the ordinary Goods Account consist, apart from the Gross Profit, of Purchases, Sales, and the Stock in trade of the two departments separately, then it is necessary for him to arrange his records so as to divide his purchases, sales, and periodical inventories of stock into the departments decided upon.

Stock on Hand.

First, as to the stock on hand. The amount of stock on hand at any date is arrived at, as previously shown, by preparing an inventory of the goods in stock at that date. In separating the departments all that is

to be done here is to add the items in the Stock Sheets independently for the two departments and pass the Furnishings stock through the Furnishings Goods Account and the Drapery stock through the Drapery Goods Account in the ordinary way.

Purchases.

The record of purchases is the Invoice Book, in which are entered the goods purchased on credit from manufacturers and wholesale houses. Ordinarily the items in this book fall to be credited to the accounts of the sellers and the monthly total debited to Purchases Account or direct to the principal Goods Account. Under the new organisation two Goods Accounts must be kept, each appropriated to some special class of goods, and the Invoice Book must be kept in such a way as will yield separate monthly totals for the two departments. This is attained by the insertion of extra columns in the Invoice Book for the classification, so that its form is then as follows (omitting the Detail column, as would be done with the Reference system of invoicing):—

	Ref. No.	C D	Fol.	Total.	Furnishings.	Drapery.
Jan. 3.	18	Goods as per Invoice	17	£45 15 0	£37 10 0	£8 5 0

The Furnishings and Drapery purchases are thus kept quite apart. The item shown in this specimen entry is credited to C D's account, "By Goods, £45, 15s.," and at the end of the month the Furnishings and Drapery columns are both summed and the totals carried to the Dr. of the "Furnishings Purchases Account" and the "Drapery Purchases Account" respectively, or direct to their respective Goods Accounts. We might prefer to copy into our Invoice Book the details of the purchases which are slumped in the specimen entry, in which case the details of the departments' amounts would stand item by item in the column of the department to which they belong.

Sales.

The sales are analysed into Furnishings and Drapery in exactly the same way as is applied to the purchases above. The Day Book is provided with the necessary classification columns, and as each credit sale is recorded the items are extended to their appropriate columns, and the total of the sale is put in the Total column.

The sales are debited to the customers' accounts, and monthly the columns are summed, the totals so ascertained being respectively credited to the Furnishings and Drapery Sales Accounts, or direct to the Furnishings and Drapery Goods Accounts.

At the time of balancing the books the Goods Accounts would then appear as follows:—

Goods Accounts.

Furnishings Goods Account.

Dr.					*Cr.*
July 1.	To Stock on hand .	£218 6 5	Dec. 31.	By Sales during half-year .	£1513 0 7
Dec. 31.	„ Purchases during half-year	976 11 10		„ Stock on hand	281 17 8
	„ Gross Profit to Profit and Loss Account	600 0 0			
		£1794 18 3			£1794 18 3
Jan. 1.	To Stock on hand .	£281 17 8			

Drapery Goods Account.

Dr.					*Cr.*
July 1.	To Stock on hand .	£146 3 7	Dec. 31.	By Sales during half-year .	£1062 10 2
Dec. 31.	„ Purchases during half-year	658 18 2		„ Stock on hand	142 11 7
	„ Gross Profit to Profit and Loss Account	400 0 0			
		£1205 1 9			£1205 1 9
Jan. 1.	To Stock on hand .	£142 11 7			

The foregoing goods accounts for the two departments show that the Gross Profit, which we formerly ascertained to have

been £1000, has been earned, £600 by Furnishings Department and £400 by Drapery Department. The Profit and Loss Account is now credited with the two sums as "Gross Profit from Furnishings" and "Gross Profit from Drapery" respectively.

The same principles are capable of application to any number of departments. Provide the Invoice Book, Day Book, and the Returns Books with a classification column for each department and proceed as explained above, keeping the goods of the various departments quite distinct in the Stock Sheets at stock-taking, and also keeping a separate Goods Account (with the subsidiary Purchases and Sales Accounts) for each of the several departments.

If the number of separate departments is large, say exceeding four or five, this method of classification becomes cumbrous, especially in dealing with the sales, and a system of dissection is then resorted to. The method of dealing with the purchases and sales is similar, and such method will therefore, for simplicity, be explained with reference to the sales only. The ordinary ruling of Day Book is employed, that with the two cash columns only, the one for the details, the other for the total of sale. This Day Book is written up from the salesmen's checks, and as each check bears the number or letter applied to the department from which the sale has been made, this letter or number is marked against each item. A clerk then provides himself with a sheet of paper ruled with cash columns headed with the numbers or letters given to each department, or a Dissection Book is kept for the purpose, and the Day Book is then analysed by every item finding a place in the departmental column to which it belongs. The totals of the departmental columns of this analysis represent the sales from the several departments, and are accordingly credited to their appropriate departmental sales accounts. This analysis may be made daily or monthly, according to the magnitude of the business. The cash sales are similarly analysed, but direct from the salesmen's checks received at the counting-house along with the cash, and the result of such analysis is carried to the departmental cash sales accounts, or sales accounts if cash and credit sales are not

Dissection.

distinguished. Instead of having the departmental purchases and sales accounts on separate folios it will be found a labour-saving device to have the departmental pages of the General Ledger with sufficient cash columns to take in all the departments' totals abreast; in this way the transfer of the monthly Dissection Book (or sheet) totals is merely a copying of the analysis totals into similar columns in the Ledger. The Purchases and Sales Accounts on both Dr. and Cr. sides would then appear thus:—

RULING OF LEDGER ACCOUNT FOR DEPARTMENTAL GOODS ACCOUNTS; BOTH DR. OR CR. SIDES ARE RULED ALIKE.

	Total.	Dept. A	Dept. B	Dept. C	Dept. D	Dept. E	Dept. F	Dept. G
Jan. 31								
Feb. 28								
Mar. 31								

A third method of separating the sales of different classes of goods into departments is to keep separate Day Books for different departments. This can only increase the clerical labour where the departments are closely allied as to the character of the goods, or are located together in one part of the establishment; but if the departments are under separate roofs or are located on different floors, and where the classes of goods are distinct, the method might be adopted with advantage. The method has no special points calling for elaboration.

Departmental Day Books.

It may also be essential to know whether it pays to continue any one of the several departments of a business, and it then becomes necessary not only to keep separate Goods Accounts to show the gross profit earned by each department, but further to allocate to each one a proportion of the general expenses charged to Profit and Loss Account. Thus in the foregoing illustration it was found that a Gross Profit was earned on each department, and

Apportioning Charges.

against this there must now be charged a share of the profit-and-loss-account items, which represent the cost of distribution, general management, and financing. The Profit and Loss Account, utilising the figures adopted before, would appear thus:—

Profit and Loss Account.

Dr. *Cr.*

		£	s.	d.			£	s.	d.
Dec. 31.	To Rent and Taxes .	£126	10	0	Dec. 31.	By Gross Profit from Furnishings Department .	£600	0	0
	„ Wages and Salaries	473	12	6		„ Do. Drapery Department .	400	0	0
	„ General Charges	210	4	0			£1000	0	0
	„ Carriages	15	4	9		„ Discounts on Purchases .	98	17	6
	„ Bad Debts and Discounts .	50	2	8		„ Dividends from Investments .	43	4	5
		£875	13	11					
	„ Net Profit	266	8	0					
		£1142	1	11			£1142	1	11

To apportion these items between the two departments some basis of division must be decided upon. In most cases the gross turnover of the departments is the most stable and the best index to the calls upon the business for outlay, and the problem in this example would then resolve itself into dividing the trade expenses into two parts which bear the ratio of £1513, 0s. 7d. to £1062, 10s. 2d., these amounts being the sales of the two departments. The sum which has to be so divided in this example is the total expenditure on Profit and Loss Account minus the creditors' discounts = £875, 13s. 11d. less £98, 17s. 6d. = £776, 16s. 5d. This amount, allocated to the Furnishings and Drapery Departments on the basis of the sales of these departments, gives £456, 6s. 3d. and £320, 10s. 2d. as the respective proportions. The final result is, therefore:—

	Furnishings.	Drapery.
Gross Profit	£600 0 0	£400 0 0
Proportion of Trade Expenses . .	456 6 3	320 10 2
Showing as Net Profit. . .	£143 13 9	£79 9 10

The Net Profit as brought out in Profit and Loss Account is therefore found to be composed of:—

Net Profit from Furnishings Department . .	£143 13 9
" " Drapery Department . . .	79 9 10
Dividends from Investments	43 4 5
Total Net Profit per Profit and Loss Account . . .	£266 8 0

The inference to be drawn from this result is that both departments are lucrative, but the Furnishings Department is more so than the Drapery Department, and accordingly the latter may receive closer attention to buying and advertising to produce a larger profit. It is thus that some practical benefit can be reaped from the keeping of proper books.

It may be considered more correct to allocate the total expenditure over the departments without deducting the creditors' discounts, especially if these are all cash discounts, on the ground that these discounts have been earned not by the departments but by the ready capital of the trader and are therefore the yield of the capital so invested, like the Dividends shown separately in Profit and Loss Account. If this view be adopted in any particular case, care must be taken to credit trade discounts before apportioning the expenditure, and the customers' cash discounts must be left out of the allocation as a finance charge not to be borne by the departments.

Should it be the case that a certain class of expenditure is particular to any one department, it is but right that it should be charged up to that department only instead of being apportioned between the departments. Thus a large portion of the Wages item in the foregoing example may be in respect of upholsterers' work in the Furnishings Department. This part of the Wages bill should obviously be charged wholly to that department, and only the general wages, say of salesmen and clerks, should be apportioned. To attain this it would be expedient to keep two Wages Accounts, one for the wages to be wholly charged to Furnishings Department—call it Upholsterers' Wages Account, the other for the general wages—call it General Wages Account. At the time of closing the books the latter would be transferred to the debit of Profit and Loss Account, the former, the Upholsterers' Wages Account, would be transferred to the debit of the Furnishings Goods Account.

Branch Accounts.

Any system of book-keeping to be designed for a business having one or more branches must admit of the profit earned in the several establishments being ascertained independently, so that it may be always quite clear whether and to what extent each is remunerative and justifies its continuance.

Branch Books.

There are two points of view from which transactions with a branch may be regarded, namely, the branch's point of view of the transaction and the head office's point of view. Let us first consider the usual course of transactions between head office and branch from the point of view of the branch. When the branch is being fitted out and equipped for business it is the head office which incurs the liabilities on its behalf, and it is also usually the head office which supplies the stock with which to commence business.

Head-Office Account.

From the very outset, then, the head office stands in the position of a creditor of the branch, and in the branch's books an account must be opened in name of the "Head Office." This account is credited through the branch's Invoice Book with all the goods supplied by the head office, and through the Journal is credited also with the initial or preliminary charges incurred and paid by the head office on account of the branch. The head office is, as it were, the principal of the branch, and the Head Office Account, therefore, stands in the branch's books in the place of a Capital Account. When the head office makes payment of any account incurred by or on behalf of the branch, it advises the branch of such payment, and the branch must then credit Head Office Account and debit the personal account of the creditor receiving the payment or the real or nominal account in respect of which the payment has been made.

Sometimes customers of the branch pay their debts to the head office; in such case, also, the head office advises the branch

of the receipt from such customer of the amount of his debt, and the branch should then debit the Head Office Account with the amount received by it, and credit the account of the customer making the payment. It is a common practice for the branch to pay over surplus cash to the head office; such payments may be in hard cash, or, if the branch keeps a separate bank account, they are by cheque on that bank account. The entries for such payments are credit cash or bank, as the case may be, and debit Head Office Account with the amount paid over. If the partners draw any money from the branches for their own use, the branch credits cash or bank with the amount so drawn, and debits Head Office Account, as the partners' accounts are kept in the head office books. Where the cash remittances or payments by the branch to or on behalf of the head office are numerous, it is preferable to carry them to a Head Office Remittance Account in the branch books to facilitate discovery and adjustment of any differences. This account is closed off at balancing to the general Head Office Account.

Goods Transferred.

It has been indicated above that goods transferred from the central business to the branch may be passed through the branch Invoice Book like purchases by the branch from the head office. Theoretically this is quite correct, but such a method of treatment would commonly be found to involve much clerical labour in posting the frequently recurring head office items. To obviate this two alternatives are open:—first, the branch may keep a separate Invoice Book for all the goods received from the head office, and the periodical (say monthly) total of this Invoice Book would then be credited to Head Office Account in one sum representing the aggregate for the period, the corresponding Dr. entry being in the Goods Account. The second alternative is to have a separate classification column in the Invoice Book for the head office goods items, so that the period's total of that column could be credited to Head Office Account in one sum. These remarks as to the branch Invoice Book apply with equal force to the Returns Outwards Book, in which are recorded all branch returns, both to head office and to creditors. Circumstances may modify any method which might be suggested, but the root idea is to group the head office items either by separate

books or by columns in such a way as to make the period's totals available for posting to Head Office Account instead of the posting of individual items being necessary.

Inter-Office Cash Transactions.

The same system of grouping to save detail postings may be introduced into the Cash Book. A Head Office classification column may be provided on the Cr. side of the branch Cash Book into which would be extended the several payments made to or on account of the head office; only the total of this column would be posted to the Dr. of Head Office Account or the subsidiary Remittance Account. A detailed statement of these payments must be sent to the head office, and from such statement the head office entry is made to the Cr. of its Branch Account for the total and the individual debits in the other accounts involved in the transaction. In the same way, if the branch frequently receives payment of head office customers' accounts, a separate classification column for Head Office may also be provided on the Dr. side of the branch Cash Book. The total of this column for the month or other period is credited to Head Office Account, and a detailed statement of such receipts is sent to the head office, from which the head office postings are made to the Dr. of Branch Account (the total) and to the Cr. of the customers who thus paid their accounts (the several items). If discounts are allowed on the customers' accounts settled in this way these must be kept distinct from the branch's own discounts, they must be borne by the head office.

Closing Entries.

The student will not, as a rule, experience any difficulty in treating the transactions between head office and branch, but at the close of the books for the financial year new considerations call for settlement. All the nominal accounts should be closed off into a Profit and Loss Account in the usual way, and when the net profit has been ascertained by that Profit and Loss Account it should be carried to the credit of the Head Office Account, as this account stands in the place of a Capital Account. Frequently it is thought not desirable for the branch employees to know the details of the profits and losses, and it is then required to close the books without showing a Profit and Loss Account in them at all. This end is attained by the balances on the nominal accounts being

directly transferred to the Head Office Account without the intervention of a Profit and Loss Account. The stock on hand at the closing of the books would not be shown in the branch books in this case. The result, so far as balancing the branch's books is concerned, is of course the same. The balance on the Head Office Account is then carried down to begin the new period with. The branch's Trial Balance is then transmitted to the head office, and from this the Branch Account in the head office books is written up, with the corresponding debits and credits in the Branch Goods Account and Branch Profit and Loss Account, according to the nature of the items. If, however, the branch has prepared its Profit and Loss Account in its own General Ledger, it must send a copy of it, along with a statement of the balances then standing on its books, to the head office, which will incorporate the information in the annual accounts of the firm. Of course it is quite possible to prepare a balance sheet of a branch business no matter how little detail is given in its books for the sake of privacy; its debits must always equal its credits. In the balance sheet of a branch the head office balance will commonly stand as a liability, and will occupy the same position as capital in an independent business. It is a usual practice for branches to be charged with interest on the balance due by them to head office, on the ground that the head office may be paying interest on its capital either to the partners or to lenders of borrowed money; in any case it is desirable to see whether the branch business pays its way on the assumption that it must pay for its borrowed capital. The branch's entry for interest of this description is, Debit Interest Account and credit Head Office Account.

From the point of view of the head office the same transactions as have been enumerated in the consideration of the branch's dealings would naturally receive the opposite effect. The branch must be regarded more or less as in the position of a customer and debtor of the head office. At the outset there are usually the initial charges paid and incurred on behalf of the branch. These payments cannot be properly charged through the head office's own Charges Account; they must be debited to the branch. Cash is credited if the transaction be a payment made, or the

Head Office Books.

personal account of the creditor credited if the debt were incurred and invoiced to the head office. The head office would next supply the opening stock, and perhaps this and the similar transfers of goods from head office to branch from time to time suggest themselves as fitting entries for the Day Book. This is hardly so, however, as the Day Book is for sales, and goods transferred to a branch cannot be rightly regarded as sales. The root difference is that a sale is at a proper selling price, and includes a margin for profit, whereas the transfer of goods to a branch takes place at cost price. It is highly desirable, then, that the value of goods sent to branches should be passed through a separate Day Book, so that the sales to customers and the transfers of goods to the branches may be kept quite distinct. This method of dealing with these transfers also results in the grouping of these transactions so that Branch Account need then only be debited with the monthly total instead of with the separate items. The corresponding credit entry for the monthly totals of these transfers of goods should not be made in Sales Account, but in a special account which may be designated "Branch Stock Account," which would be closed into the Cr. of Goods Account at the closing of the books.

Stock Transferred.

When the head office has occasion to meet any debts due by the branch it credits cash or bank, according as the payment is made in cash or by cheque, and debits the Branch Account, and advises the branch of the payment in order that it may pass the entry through its books, giving the head office credit for such payment.

Cash Transactions for Branch.

If the head office receive payment of any debt due to the branch it debits cash and credits the branch, and in due course advises the branch of the receipt of such sum in order that it may credit the customer and debit the head office for the transaction.

When the head office draws cash from the branch either in coin or by cheque upon the branch's special bank account, the entry is Cash Dr. and the Branch Account Cr., and in the event of one of the partners drawing cash or goods from the branch for his own use, the head office must credit Branch Account with such drawings and debit the Drawings Account of the partner concerned.

When head office and branches are so situated that there are frequent transactions by one on the other's behalf by way of receiving settlement of customers' accounts, settling creditors' accounts, and similar dealings, the ordinary form of advice is a stated return, weekly or twice weekly. These returns or advices are regularly filed and the postings made directly from them, or details such as numerous customers' accounts settled may be posted direct from the advices and the other items journalised for the postings. The method to be employed depends on the circumstances of any particular business and the other counting-house methods in use, but the general plan must be to debit Head Office Account or Branch Account, as the case may be, and credit the customers' or other accounts concerned, or credit Head Office Account or Branch Account and debit the creditors' or other accounts concerned.

Branch Returns.

In some businesses the branch establishments are controlled from the head office and strictly supervised; commonly in such cases the customers' accounts are all kept at the head office. This necessitates a regular series of advices by the several branches to the head office to keep the books written up to date. The credit sales are recorded in the Day Book at the branch, and if two Day Books be kept for use on alternate days, one can be sent to the head office each morning to be posted up by the staff there, while the other is at the branch for the recording of the day's transactions. Cash sales should be recorded in daily total in the branch Cash Book in the ordinary way, and also all expenses paid from the branch. A summary of such cash transactions falls to be made to the head office at short intervals, daily or weekly, for the incorporation of those transactions in the proper books kept at the head office; likewise all customers' accounts settled at the branch must be advised immediately to the head office in order that the accounts of the several customers may be credited with the payments. Accordingly, a complete cash summary should be transmitted by the branch to the head office, and if possible such summaries should be filed and made available for direct posting so as to save clerical labour. The following form is suggestive of the requisites of such summaries:—

..................BRANCH.

CASH SUMMARY FOR THE WEEK ENDING..................19 .

Binding margin, not to be written on.

Receipts.	Fol.	£ s. d.	*Payments.*	Fol.	£ s. d.
Cash Sales—			Wages		
Monday			Charges		
Tuesday			Carriages		
Wednesday . . .			Remittances to Head Office [or Payments into Bank] (*Dates and Amounts*) .		
Thursday					
Friday					
Saturday			Other Payments, viz.:—		
Total for week .			Payments for week .		
Book Debts, as below . .			Balance on hand, to next Statement . . .		
Other Receipts, viz.:—					
Receipts for week .					
Balance on hand, from last Statement. . . .					

Book Debts Collected.

Name.	Fol.	Discount.	Cash.	Name.	Fol.	Discount.	Cash.	Name.	Fol.	Discount.	Cash.
		£ s. d.	£ s. d.	Forward.		£ s. d.	£ s. d.	Forward.		£ s. d.	£ s. d.
								Total Discount .			
Forward.				Forward.				Net Collection carried to Summary . .			

The series of such summaries when filed is regarded as part of the book-keeping system, so that the Branch Cash Sales Account, for example, is credited with the weekly total shown in the Summary, and the folio of that account is placed on the Summary against the complementary Dr. entry; in fact these summaries represent the Branch Cash Account so far as the head office books are concerned. The accounts of the several customers who have settled their debts at the branch establishments are credited directly from the Summary, the corresponding Dr. entries being the aggregate of these accounts on the Receipts side. The discounts must receive a double posting, however, as the Cash Account is not Dr. or Cr. for discounts; the entry is Branch Discount Account Dr. for the total, and the several customers' accounts Cr. for their respective items.

The foregoing Summary is employed where the branch has no independent book-keeping system, all the book-keeping being done at the head office, but where the accounting relations between head office and branch allow the branch more independence the adjustment of the accounts at the periodical balance requires consideration.

Closing Entries.

At the close of the firm's financial year the books of the head office are written up in the usual way, and the head office Profit and Loss Account prepared in the manner familiar to the student. At the same time the branch is having its books closed, and in due time a statement is received from the branch showing the result of its period's trading. Such statement may be in one of two forms. First, the branch may prepare its own Profit and Loss Account and transfer the net profit to the credit or the loss to the debit of the Head Office Account, and then prepare its separate Balance Sheet showing the Head Office Account balance as a liability; or such statement received by the head office from the branch relating to its balance may be a Trial Balance, giving the balances standing on the various nominal accounts and all the other information necessary to enable the head office to prepare the Profit and Loss Account and Balance Sheet of the branch and to incorporate the results in its own statement. In the former case the head office must, in its own books, credit its Branch Account with any loss shown on the branch Profit and Loss Account, or debit it with any profit earned, on the ground that the branch is responsible to the head office for the amount of the original investment plus profits or minus losses. If the information be forwarded in the form of a Trial Balance, the head office must prepare a Branch Profit and Loss Account in its own books, debiting that account with the expenditure shown in the Trial Balance, and crediting it with the sources of income shown therein. The corresponding credit and debit entries, respectively, are made in the Branch Account, or the Branch Account may only be debited with the net profit brought out or credited with the loss shown on the Branch Profit and Loss Account when the result has been ascertained.

The net profit brought out on the head office's own Profit and Loss Account is carried off to a general Profit and Loss Account, called also "Net Profit Account," and the net profit or loss brought out on the Branch Profit and Loss Account is also transferred to that general account. The balance on this General Profit and Loss Account then represents the earnings or loss on the combined businesses, and such profit or loss is then carried to Capital Account, or in the case of a firm is allocated between the partners.

Balance Sheet.

In the balance sheet of the head office the balance due by the branch should not be lumped with the other debts such as customers' accounts, but should be separately stated. The balance on the Branch Account in the head office books should always agree with the balance on the Head Office Account in the branch books, but they must of course appear on opposite sides, that is to say, if in the head office books the Branch Account be Dr. for a certain sum, then in the branch books the Head Office Account will be Cr. for the same sum. If, therefore, the head office and the branch have each a separate balance sheet prepared, the amount standing in the head office balance sheet as an asset in respect of the debt due by the branch will agree with the amount of the liability to the head office standing on the branch's balance sheet. Clearly, then, if the balance sheets of the head office and the branch are amalgamated, these two items compensate one another and are extinguished.

Foreign Branches.

The dealings between a home head office and a foreign branch are usually limited in number, and those transactions which do take place between them are of the nature of one or other of the transactions referred to in connection with home branches, and therefore lend themselves to the same treatment. The distinguishing feature of the accounts of a foreign branch is the question of exchange. This must be dealt with when it is required to set out the results of head office and branch side by side or to incorporate them in one general Profit and Loss Account and Balance Sheet.

Exchange.

During the ordinary course of business the home house records its transactions in the currency in which these take place, and likewise the foreign branch records its transactions in the currency in use in its own sphere of operations; but at the end of the financial year the branch has to transmit a copy of the trial balance of its books to the head office in order that the firm's accounts may be prepared and the result of the year's trading as a whole ascertained. This branch trial balance, being taken off the foreign office books which have been kept in the currency of the country in which the branch is situated, is expressed in the foreign currency. It is necessary before the branch trial balance figures can be passed through the home books that they should be converted into sterling, and it is the rate of exchange at which this conversion is to be made which must be carefully considered. If we convert all the sums in the trial balance at the rate of exchange ruling at the date of the balance we might be assigning to certain of the assets too low or too high a value. For example, the buildings or other fixed asset may stand on the branch books at a very fair market value, but if we convert this value into sterling at the ruling rate of exchange, when the rate is against this country, the result would be that the value of the asset would be overstated in sterling, and at the next balance of the accounts, if the exchange were then in favour of this country, a sudden drop in the value of that asset would appear on the face of the

Rules for Conversion.

balance sheet, whereas the asset itself may have suffered little actual depreciation in the interval.

On the other hand, certain assets are being realised every day, such as the book debts which are being collected, the stock-in-trade which is being sold, and other floating assets, and the proceeds of these transactions are being remitted home. It is clear that these assets could most properly be stated at their value at the rate ruling at the date of the balance on the assumption that they may be realised immediately, and the proceeds remitted home at the rate of exchange then ruling.

Then again, the items in the trial balance which give the information as to the expenditure and income of the foreign branch, *i.e.* the balances of the nominal accounts shown in the trial balance, are facts as to profits earned and expenditure incurred during the period that has just closed, and if we desire to express the true ratios of these transactions in the statements which we are to prepare in sterling, we must convert these balances at the rates of exchange ruling when the transactions took place. This is, of course, impracticable, as the transactions have been many, but we may assume that they have been evenly spread over the trading period, and we shall accordingly be near the truth if we convert these items at the average rate for the period.

We would thus have three different principles on which to go in the process of converting foreign currency into sterling, and that quite apart from the balance which may be due to or by the branch to the home office.

These three principles may be stated thus :—

1. All fixed assets such as buildings, machinery and other plant, and other like assets which do not waste rapidly should be taken into the balance sheet at the rate of exchange ruling when they were first installed. The original cost is easy of ascertainment, and this should be carefully written down as the subjects depreciate, but no fluctuations in the rate of exchange at which the assets stand in the head office books ought to enter into the treatment of these items in the accounts. Liabilities not payable until some fixed future time, such as loans, should also be included at their original value.

2. All floating assets such as the cash and bank balances, the book debts, and the stock-in-trade, and also liabilities presently payable, should be converted at the rate ruling at the date of the closing of the books. These assets may be realised and remitted home any day, and the liabilities liquidated at any time, and they should therefore be taken into the accounts at their present value, that is their value at the date of the balance sheet.
3. The items of profit and loss refer to transactions which have taken place over the trading period, as already pointed out, and to ascertain and show in the accounts the nearest possible value of these items they should be converted at the average rate of exchange ruling over the period to which the profit and loss accounts relate.

The balance due by the branch to the head office will of course also be shown in the trial balance of the branch books in the foreign currency. This balance should represent the same value as the balance on the Branch Account in the head office books, but in the head office books it is expressed in sterling. The ratio of the sterling balance to the foreign currency balance is neither the rate ruling at the close nor the average rate for the period; the items in this particular account are of such a composite character that no conversion principle can be deduced. The proper method of substituting sterling for the foreign currency amount of this balance is to insert in the converted trial balance the sum at which such balance stands on the Branch Account in the head office books. To have the Branch Account in the home books correspond exactly with the Head Office Account in the branch books some prefer to record in the Branch Account in the home books not only the sterling value of each transaction, which is the real entry, but also the corresponding expression in the foreign currency. The obvious advantage of this course is that any discrepancy between these two accounts can be very readily traced and adjusted.

Adjustment of Accounts.

Having decided upon the rules for our conversion of the trial balance figures, we simply rewrite the trial balance submitted to us by the foreign branch, inserting the sterling values of the items instead of the foreign currency figures as in the original. When we got the trial balance from the branch the two sides agreed, for their books were on the balance; but when we have applied to the different items in the trial balance our own arbitrary rules of conversion into sterling, the Dr. and Cr. sides no longer agree. To put matters right we add to the smaller side the amount required to square the trial balance, writing in the difference as profit or loss on exchange. If the amount is written in on the Dr. side it will be a loss on exchange, and if on the Cr. side it will be a profit on exchange. This profit or loss on exchange should be debited or credited, as the case may be, to the Profit and Loss account.

The branch profit and loss account is then prepared, Profit and Loss Account being debited with the expenditure shown in the trial balance and the Branch Account credited therewith, and the Profit and Loss Account is credited with the profits shown in the trial balance, these figures being debited to the Branch Account. That is one way, but it is quite satisfactory for the Profit and Loss Account of the branch to be prepared in the head office books without reference to the Branch Account at all in the first instance, and when the profit has been so ascertained an entry can be passed debiting the Branch Account and crediting the general Profit and Loss Account with such profit. The general Balance Sheet of the concern, both home and foreign businesses being included, can then be prepared, the assets and liabilities of the branch being stated at their converted values as shown in the new trial balance, and the head office assets and liabilities at their values as in the head office books.

Foreign Trade.

Exchange.

When the transactions of a commercial house engaged in foreign trade come under consideration we have, in addition to the general questions falling to be dealt with in the counting-house, to reckon with the element of foreign exchange. The customs of trade vary widely in different circles, and, further, the terms of the contract between buyer and seller may regulate its fulfilment subject to the law's restrictions; consequently, no invariable generalisations on usage and routine can be indulged in for the guidance

2. All floating assets such as the cash and bank balances, the book debts, and the stock-in-trade, and also liabilities presently payable, should be converted at the rate ruling at the date of the closing of the books. These assets may be realised and remitted home any day, and the liabilities liquidated at any time, and they should therefore be taken into the accounts at their present value, that is their value at the date of the balance sheet.
3. The items of profit and loss refer to transactions which have taken place over the trading period, as already pointed out, and to ascertain and show in the accounts the nearest possible value of these items they should be converted at the average rate of exchange ruling over the period to which the profit and loss accounts relate.

The balance due by the branch to the head office will of course also be shown in the trial balance of the branch books in the foreign currency. This balance should represent the same value as the balance on the Branch Account in the head office books, but in the head office books it is expressed in sterling. The ratio of the sterling balance to the foreign currency balance is neither the rate ruling at the close nor the average rate for the period; the items in this particular account are of such a composite character that no conversion principle can be deduced. The proper method of substituting sterling for the foreign currency amount of this balance is to insert in the converted trial balance the sum at which such balance stands on the Branch Account in the head office books. To have the Branch Account in the home books correspond exactly with the Head Office Account in the branch books some prefer to record in the Branch Account in the home books not only the sterling value of each transaction, which is the real entry, but also the corresponding expression in the foreign currency. The obvious advantage of this course is that any discrepancy between these two accounts can be very readily traced and adjusted.

Adjustment of Accounts.

Having decided upon the rules for our conversion of the trial balance figures, we simply rewrite the trial balance submitted to us by the foreign branch, inserting the sterling values of the items instead of the foreign currency figures as in the original. When we

got the trial balance from the branch the two sides agreed, for their books were on the balance; but when we have applied to the different items in the trial balance our own arbitrary rules of conversion into sterling, the Dr. and Cr. sides no longer agree. To put matters right we add to the smaller side the amount required to square the trial balance, writing in the difference as profit or loss on exchange. If the amount is written in on the Dr. side it will be a loss on exchange, and if on the Cr. side it will be a profit on exchange. This profit or loss on exchange should be debited or credited, as the case may be, to the Profit and Loss account.

The branch profit and loss account is then prepared, Profit and Loss Account being debited with the expenditure shown in the trial balance and the Branch Account credited therewith, and the Profit and Loss Account is credited with the profits shown in the trial balance, these figures being debited to the Branch Account. That is one way, but it is quite satisfactory for the Profit and Loss Account of the branch to be prepared in the head office books without reference to the Branch Account at all in the first instance, and when the profit has been so ascertained an entry can be passed debiting the Branch Account and crediting the general Profit and Loss Account with such profit. The general Balance Sheet of the concern, both home and foreign businesses being included, can then be prepared, the assets and liabilities of the branch being stated at their converted values as shown in the new trial balance, and the head office assets and liabilities at their values as in the head office books.

Foreign Trade.

Exchange.

When the transactions of a commercial house engaged in foreign trade come under consideration we have, in addition to the general questions falling to be dealt with in the counting-house, to reckon with the element of foreign exchange. The customs of trade vary widely in different circles, and, further, the terms of the contract between buyer and seller may regulate its fulfilment subject to the law's restrictions; consequently, no invariable generalisations on usage and routine can be indulged in for the guidance

of book-keepers employed in houses engaged in import or export trade. It is more the province of economic science to unfold the causes and effects of the exchange fluctuations, and we shall therefore investigate only the points of outstanding general interest to familiarise the student with the general trend of the matter. A special study can be undertaken under the guidance of the authorities on the subject, such as Goschen's *Theory of the Foreign Exchanges*, or Clare's *A B C of the Foreign Exchanges*. A rate of exchange is the price of one country's currency expressed in terms of the currency of another country; thus, "London receives Fr. 25.22 for £1 sterling," and "London gives 1s. 3 31-32d. for 1 rupee."

Exchange Fluctuations.

The reason for the existence of a rate of exchange is the use of different standards in the measure of value in different countries, and the main reason for the continual fluctuations in the quotations is the continual changing of the balance of indebtedness existing between two countries, or, more accurately, the fluctuations are mainly caused by the varying demand for and supply of bills of exchange available to liquidate the immediately-due debts between the countries. The unit of value in the United Kingdom is the sovereign, in France it is the franc, in Germany the mark, in the United States the dollar, and so on. These different standard coins are of different intrinsic value, that is as metal, and when we have found and expressed the value of each of the foreign standards in terms of our sovereign we have the Pars of Exchange between Britain and these countries. Apart from other influences, then, the rate of exchange between this country and any foreign country would be the ratio which its standard coin bears to ours intrinsically; but, besides having different units of value, there is also the fact that at one time Britain owes more, say to France, than France owes to Britain, that is, the balance of indebtedness (for immediate settlement) is against us; and as this balance is settled by means of bills of exchange, the supply in Paris of bills drawn on London is in excess of the demand, and the bills accordingly realise less than their par value. For example, the par of exchange between London and Paris is Fr. 25.22½ for £1 sterling, but in the case supposed our French debtors

would get all the bills they required at a less rate, because of the abundant supply of London bills available in the hands of our French creditors. Therefore, from the operation of such influences, at one time for and at another against us, the rate of exchange between France and Britain will be found quoted in the daily papers, not at the par rate of 25.22½, but at anything between approximately 25.12 and 25.32, according to the balance of indebtedness of one country to the other. These extreme rates are the approximate "specie points"; when they have been reached it might be more profitable for a French creditor holding a bill to import the actual coin (and thus realise par less cost of importing) instead of selling his bill at the low rate quoted, and for a French debtor to export the coin in settlement of his debt (and pay the cost of exporting) rather than buy a bill at the high rate quoted. The 10 centimes difference between par and the two specie points given covers the cost of transmission of the bullion.

Settlement of Indebtedness.

London is recognised as the "world's clearing house," and it has on this account become a custom of trade for foreign creditors to draw on their British debtors and sell the bills to the foreign debtors of British traders. Therefore, in the majority of cases, when the foreign merchant is the creditor he draws on the British trader payable in London and sells the bill to his banker or bill-broker; when the foreign merchant is the debtor he purchases a bill on London from his banker or a bill-broker and transmits it to his British creditor. As the sums in foreign bills are commonly expressed in the money of the country on which they are drawn, and the majority of bills with which we are concerned are drawn on London, our bills are usually drawn in sterling, and the competition for them, whether strong or weak, between the holders who want to sell and the debtors who want to buy to remit to their creditors determines the price of them, that is, the rate of exchange at which they are negotiated. The sum in a bill expressed in sterling is the constant and the foreign currency equivalent is the variable. It will thus be seen that any loss or gain on exchange in these cases falls on or accrues to the foreign merchant drawing and negotiating the bill. The

following diagram illustrates the ultimate result of the operations in a settlement by bill, and will enable the student to understand the nature of the transaction:—

C (D's creditor) Paris	1 draws on	D (C's debtor) London
2 sells to		4 collects from
A (B's debtor) Paris	3 remits to	B (A's creditor) London

Here C in Paris has to collect a debt from D in London, and A in Paris wants to pay B in London a similar amount. C draws on D and sells the bill to A, who sends it over to B, and B collects the amount of the bill from D. The transaction would not be carried through directly between the parties in this way of course, but the nature of the transaction is made clear. The illustration shows that the creditor in Paris (C) draws on his London debtor, and the debtor in Paris (A) buys the draft and remits to his London creditor. C's claim is thus "drawn for" and A's debt "remitted for." In certain industries British houses invoice goods in foreign currency and draw upon the debtors in that currency, and consequently these houses may realise more or less than the par value of their drafts according to the rate of exchange ruling at the time when they negotiate these drafts. It is obvious, then, that a book-keeper in a house undertaking a foreign trade which involves gain or loss by the fluctuations of the exchange should be familiar with the currencies of the countries with which his house has dealings, and everyone interested in commerce should at least have at his finger-tips the par value of the principal monetary standards. From day to day the newspapers show the course of the exchanges, but only the fluctuating values are shown, and unless the reader has the par values in his memory for comparison the quotations are almost meaningless. The student should observe that certain of the

Exchange Quotations.

rates are quoted in the foreign currency for £1 sterling, and others are quoted in sterling for the foreign standard coin. Instances of the former are the francs and centimes of France and the marks and pfennige of Germany, and examples of the latter are the rupees of India and the dollars of the Far East. The quotations are ordinarily given in two groups, the first showing the foreign equivalent receivable for £1 sterling, and the second the amount to be given in sterling for the foreign unit. In some lists the United States dollar is quoted in pence sterling, and in others at dollars for £1 sterling; thus $49\frac{5}{16}$d for $1, and 4.85. The Russian rouble is quoted in pence, and also in roubles for £10 sterling, thus $24\frac{15}{16}$d for 1 rouble, and 94.30.

In considering the theory of the exchanges the "short rate of exchange" alone is dealt with, that is the rate for cheques and sight and demand bills, and we have seen that this short rate fluctuates round the par of exchange according to the balance of indebtedness between the countries to the transaction. The "long rate" for bills at a term exceeding three days is based upon the short rate, the difference being the interest for the term of the bill, foreign bill stamp duty, and a margin to compensate for the risk of granting credit during that currency.

Course of Exchange.

The following is the "Course of Exchange" from one of the leading dailies:—

The Exchanges.

The following are the rates of exchange on London cabled from the chief commercial centres:—

	To-day.	Previous.
Paris, cheques	25.15	25.15
Brussels, cheques . . .	25.20—21	25.20—21
Geneva, sight	25.11	25.11
Berlin, cheques . . .	20.39—40	20.39—40
Berlin, 8 days	$20.38\frac{1}{2}$	$20.38\frac{1}{2}$
Berlin, 3 months . . .	$20.30\frac{1}{2}$	$20.30\frac{1}{2}$
Hamburg, cheques . . .	$20.39\frac{1}{4}$	$20.39\frac{1}{4}$
Vienna, sight	$23.93\frac{1}{2}$—$95\frac{1}{2}$	$23.93\frac{1}{2}$—$95\frac{1}{2}$
Copenhagen, sight . . .	18.15	18.15
Stockholm, sight . . .	18.15	18.15
Amsterdam, sight . . .	$12.07\frac{1}{2}$—08	$12.07\frac{1}{2}$—08

	To-day.	Previous.
Barcelona	28.17	28.17
Italy, sight	25.11$\frac{1}{2}$—13$\frac{1}{2}$	25.11—13
Athens, sight	27.05	27.05
Madrid, sight	28.15—25	28.10—20
Lisbon, sight	46$\frac{5}{8}$d.	46 9-16d.
St. Petersburg, three months .	94.75	94.75
Constantinople	110.00	110.00
Rio, ninety days . . .	15d.	15d.
Valparaiso, ninety days . .	9 15-16d.	9$\frac{7}{8}$d.
Buenos Ayres, ninety days .	48$\frac{1}{4}$d.	48$\frac{1}{4}$d.
Monte Video, ninety days. .	51$\frac{5}{8}$d.	51$\frac{5}{8}$d.

The rates telegraphed from the East were :—

		To-day.	Previous.
Bombay tele. trans.	(per rup.) .	1s. 3$\frac{7}{8}$d.	1s. 3$\frac{7}{8}$d.
Calcutta ,,	(per rup.) .	1s. 3 27-32d.	1s. 3 27-32d.
Singapore ,,	(per dol.) .	2s. 3 13-16d.	2s. 3 13-16d.
Manila ,,	(per dol.) .	2s. 0$\frac{1}{4}$d.	2s. 0$\frac{1}{4}$d.
H.-Kong ,,	(per dol.) .	1s. 9$\frac{1}{4}$d.	1s. 9$\frac{1}{4}$d.
Shanghai ,,	(per tael) .	2s. 4$\frac{3}{8}$d.	2s. 4$\frac{3}{8}$d.
Yokohama ,,	(per dol.) .	2s. 0$\frac{3}{8}$d.	2s. 0$\frac{3}{8}$d.

The buying rates for merchants' bills on the East were :—

	To-day.	Previous.
India, thirty days (per rup.) .	1s. 3 23-32d.	1s. 3 23-32d.
Straits, sixty days (per dol.) .	2s. 3$\frac{3}{8}$d.	2s. 3$\frac{3}{8}$d.
Hong-Kong, sixty days (per dol.)	1s. 8$\frac{3}{4}$d.	1s. 8$\frac{3}{4}$d.
Shanghai, sixty days (per tael) .	2s. 3$\frac{3}{4}$d.	2s. 3$\frac{3}{4}$d.
Japan, sixty days (per yen) .	2s. 0d.	2s. 0d.

The foregoing may be interpretated thus—

Paris . / Brussels . / Geneva .	Francs and Centimes for £1; contracted Fr. (with decimals)			
Berlin . / Hamburg	Marks and Pfennige for £1	,,	M.	,,
Vienna . .	Florins and Kreutzers for £1	,,	Fl.	,,
Copenhagen / Stockholm	Kronas and Ore for £1	,,	Kr.	,,
Amsterdam .	Guilders and Stivers for £1.			
Barcelona / Madrid .	Pesetas and Centesimos for £1	,,	Pes.	,,
Italy . .	Lire and Centesimi for £1	,,	L.	,,
Athens . .	Drachmes and Lepta for £1	,,	Dr.	,,
Lisbon . .	Pence for 1 Milreis	,,	Milr.	,,
St. Petersburg.	Roubles for £10	,,	Ro.	,,
Constantinople	Piastres for £1.			
Rio . . .	Pence for 1 Milreis.			
Valparaiso / Buenos Ayres / Monte Video	Pence for 1 Peso.			

Foreign Mercantile Bills commonly originate as Documentary Bills, that is, bills to which are attached the documents being transmitted in connection with the transaction against which the bills are drawn. These bills like other foreign bills are drawn in sets of two or three, the separate bills or parts being termed respectively the First, Second, and Third. To each of these parts are attached a Copy Invoice for the goods sold, and a Copy Bill of Lading, which is the shipmaster's receipt for the shipment of the goods and forms the document of title to the goods. To the First there should also be attached the Policy of Marine Insurance covering the goods in transit. Each copy of the draft should be endorsed in blank by the drawer, and each copy of the Bill of Lading also, when drawn to his order, and, with the other documents attached, these are delivered to the Bankers who have agreed to discount the draft or give credit against it. The Bankers transmit the draft and documents by different routes or different mails to their correspondents in the place on which the bills are drawn, and these correspondents present one of the parts to the drawee for acceptance. On one part being duly honoured the other parts are void. On obtaining acceptance of one of the parts the Bank's correspondents deliver up the documents to the acceptor if the bill was drawn bearing the words, "Documents to be surrendered against acceptance;" but the more usual course is to deliver the documents only on payment of the bill, which may be at maturity or under discount before maturity. It is imperative that when the shipment and negotiation of the drafts have been arranged the drawee should be advised, naming the Bankers through whom presentation for acceptance of the draft will be made, so that he might be prepared to accept without hesitation, and to take immediate delivery of the goods and retire the bill under discount if so disposed.

Documentary Bills.

The following is a form of "clean" foreign bill, that is, one to which no mercantile documents are attached, drawn in London on Berlin :—

No. 5163. £100 Stg. London, 19 .

At Fourteen days' sight pay this First of Exchange (Second being Unpaid) to the Order of Ourselves the sum of One hundred pounds sterling payable at the rate of exchange as per endorsement, value received in account.

To C D, A B.
Berlin.

The following is a form of documentary bill (termed D/A = documents attached):—

No. 3615. New York, 19 .
Exchange for £165.

Sixty days after sight of this First of Exchange (Second unpaid) pay to the order of [Bank] the sum of One hundred and sixty-five pounds sterling, value received in [Goods], which place to account as advised. Shipping documents attached to be surrendered on payment only.

To C D, A B.
Edinburgh.
Payable at London, England. *In case of need apply to X Y Z, Liverpool.*

Another form (employed in East trade):—

Documents to be surrendered on payment only.

No....... Edinburgh,.....................19......
£.........

.........days after sight pay this [First] of Exchange ([Second] and [Third] unpaid) to...........order the sum of.................. sterling payable at the [Foreign Bankers'] drawing rate for demand Drafts on London, with interest at [6] per cent. per annum added thereto from date hereof to approximate due date of arrival of the remittance in London, value received.

To........................ ....
....
....

Occasionally foreign bills are drawn "at usance"; "usance" signifies the usual term for which bills are drawn on certain

commercial centres. The custom is falling into disuse, and the exact currency of the bills is being stated as a general practice. The following are the principal usances:—

Usance.

Berlin and Vienna	14 d/s
Hamburg and the Netherlands	1 m/d
Bordeaux, Paris, Geneva, and Malta	30 d/d
New York	60 d/s
Spain and Gibraltar	2 m/s
Italy generally	3 m/d

Consignment Accounts.

Commercial houses often find it advantageous to send quantities of their merchandise to mercantile factors for sale on commission. These goods are spoken of as consignments. The goods which are consigned never become the property of the factor or agent; the property of the goods remains in the merchant, and the agent only acts on the specific instructions of his principal or according to the custom of the trade and locality. These transactions thus have two very different aspects, that of the merchant, who is the "consignor," and that of the agent, who is the "consignee."

First as to the consignor's books. It is a principle in the treatment of consignments that each parcel of goods must be kept distinct so as to show what profit has been realised on it, and accordingly for each consignment there is kept a separate consignment account bearing a distinctive name or number. These consignment accounts are debited with the cost price of the goods and also with all charges paid or incurred on account of the consignments, and credited with the proceeds of the sale of these goods; the accounts then show the result of the deals in profit or loss.

Consignor's Books.

When the consignor has resolved to consign a quantity of his goods to an agent for sale on commission, the first transaction is the despatch of the goods to that agent. So far as

the consignor's accounts are concerned, this is clearly goods going out, therefore Goods Account must be credited with the goods, and the particular consignment account debited. It is quite wrong to pass a consignment of goods through the sales day book, because goods consigned are not sold, and as they are charged to Consignment Account at cost they should clearly not be mixed up in the day book with goods sold to customers at selling price. According to the magnitude of the business, one of two methods can be adopted. If the consignments are numerous a special day book, distinguished by the name of Consignments Outwards Book, can be kept for them; the other method is to journalise the goods consigned, debiting the individual consignment accounts and crediting Goods Account with each, but this method is only to be recommended when the consignments are few in number. As to the former method, then—this Consignments Outwards Book is summed monthly or for such other period as may be deemed most suitable, and the total is credited to the Goods Account "By Consignments"; the individual items in this Consignments Outwards Book are debited separately to the respective ledger accounts opened for the several consignments.

C O Book.

In connection with the despatch of the goods the consignor may have to make payment of charges for freight, insurance, cartage, and other expenses. These amounts are credited to the Cash Account for the payment made, and from the Cash Book are posted to the Dr. of the consignment account concerned. Note that such charges are not posted to the general expense accounts; each consignment must bear its own charges.

Charges Paid.

The consignor advises the agent of the despatch of the goods, commonly invoicing the goods to him at the minimum price at which he is to sell, and then awaits the agent's advice of the sale of the whole or any part of the goods. This is usually sent in the form of what is known as an Account Sales, of which the following is a specimen:—

Account Sales.

Account Sales of [*Goods*].

Ex. S.S. from Sydney to London.

Sold by A & B, London

on account of C & D, Sydney.

Marks	Parcels		T	C	Q	L	Rate						
		By *Particulars of Sales* . . .											
		less 2½ per cent. discount .											
		To Charges—											
		Dues paid.											
		Freight											
		Warehousing and porterage .											
		Insurance £ at per cent. .											
		Commission at 2½ per cent. on £											
		Net proceeds carried to account .											
		E & O E											
		London, 31st January, 19 .											
		(Sgd.) A & B.											

The foregoing Account Sales shows first of all the gross amount of the sales with the quantities and rates, then it details the agents' charges for outlays and commission, extending the total of these charges to the outer money column and showing this total deducted from the gross sales. The net proceeds brought out is the amount for which the agents have become indebted to the consignors. The consignors on receiving this Account Sales may credit the Consignment Account with the gross sales, and debit it with the charges for the sake of giving fullest details of the transaction, or the more usual course, they may simply credit the Consignment Account with the net proceeds brought out in the Account Sales. The complementary debit for this credit entry depends on how the balance is to be accounted for. (1) The agents may send their cheque for the

balance due when forwarding the Account Sales, in which case Cash Account must be debited and the Consignment Account is credited by the posting from the Cash Book; or (2) the agents may enclose their bill for the balance on the Account Sales, when the bill must be passed through the Bills Receivable Book, and the posting from this gives the Consignment Account credit; or (3) if the agents have frequent dealings with the consignors, the balance on this transaction may not be remitted in any form, but simply placed by them to their principals' account. In this last case the consignors, on receiving the Account Sales, debit the agents' personal account with the net proceeds and credit the Consignment Account. This entry should be passed through the Journal.

Drafts.

When goods are consigned the consignor sometimes draws on the agent against these goods, that is, he draws a bill on the agent at a fixed term in anticipation of the sale of the goods by which the agent shall have become his debtor ere the bill matures. When a bill is so drawn it is passed through the Bills Receivable Book, and from thence posted to the credit of the agent's personal account, and when the Account Sales is rendered the amount of the net proceeds is debited to the agent's account and credited to the Consignment Account. This method shows the true relation of the parties at any stage of the transaction.

The Consignment Account, so far as we have examined it, shows on its Dr. side the cost of the goods and all charges connected with the consignment of them, and on its Cr. side it has the net proceeds as brought out in the Account Sales. If the Cr. side exceeds the Dr. the result is profit, and the account will be closed by debiting Consignment Account and crediting Profit and Loss Account.

Unsold Consignments in Stock.

The one point of difficulty in connection with these consignments is the treatment of the balance on the Consignment Account at the closing of the books for the annual balance at which time any portion of the consignment remains unsold. Business prudence forbids the anticipation of profit on any venture pending its completion, but there are two methods, either of which can be adopted. These are illustrated by the following example :—

Consignment Account No. 7/1911.

Dr.			*Cr.*		
Jan. 12.	To Goods consigned (per C/O Book)	£910	Oct. 13.	By A B on account of consignment, one-half sold .	£600
17.	„ Cash for half freight . .	70			
Feb. 9.	„ Cash for insurance and sundry charges . .	20			
		£1000			

Suppose that Consignment Account showed the foregoing features at 31st December when the books were being balanced for the financial year, the question arises what profit is to be taken credit for, if any, and at what value is the remainder of the consignment to be carried forward? If the total cost of the goods and the charges of their consignment amounted to £1000, and one-half of the quantity has been disposed of at a profit, the value of the remaining portion (£500) might very well be credited to the account and carried down as the value of the asset in the consignment. This method would result in the profit realised on the half sold being transferred to Profit and Loss Account for the past year. On the other hand, most consignments are of a more or less speculative nature, and in many cases it is hardly prudent to take credit for any profit whatever until the whole quantity of goods has been disposed of, as not infrequently the high prices realised on the sale of the first portion are not maintained, and the last parcels of the goods might be sacrificed to have the deal closed. On these considerations the balance of £400 shown on the above account as it stands should be carried down and nothing transferred to Profit and Loss Account for the past year; any profit earned or loss sustained on the whole transaction will fall into the next year's accounts.

Consignee's Books.

Turning now to the consignee's books: The first step relative to a consignment is the receipt of the advice from the consignor of the despatch of the goods. The goods are invoiced to the consignee, but for that reason it must not be looked upon by him as a

purchase; the goods are not his nor at his risk, he is merely the custodian of them. He therefore receives the goods and makes arrangements for their present warehousing and subsequent sale. To keep a record of the goods thus received, an entry may be made in a book specially appropriated to this purpose called the Consignments Inwards Book. This book, although bearing this name, is not the converse of the Consignments Outwards Book. The Consignments Inwards Book is nothing more than a formal record of the description, quantities, marks, and other particulars of the goods belonging to other parties to be sold on commission. The agent's first real transaction is when he makes payment of any charges. The entries for these are Cash to be credited with the payment made and the postings from the Cash Book to be made to the debit of the proper Consignment Account.

When the consignee effects a sale of any part of the consigned goods he must credit Consignment Account with the amount of such sale. If it be a cash sale, Cash Account is debtor; but if it be a sale on credit, the personal account of the customer buying the goods is debtor. The entries for credit sales of the consigned goods must not be passed through the consignee's own Day Book to be reckoned as his own goods sold; such sales must go through his Journal, the purchaser Dr. to the Consignment Account. If the consignee act as factor for frequent consignments he should keep a specially-ruled Consignment Journal, of the ordinary ledger ruling, with the name of the purchaser to be debited on the left side and the particular consignment account to be credited on the right side. When all the goods are disposed of he makes out the Account Sales in the form we have already discussed. This Account Sales, the student will observe, will correspond with the entries in the Consignment Account in the consignee's Ledger, in which the sales appear on the Cr. side and the various outlays on the Dr. side. There is still the entry to make for the commission which the consignee has earned by negotiating the sale of the goods for his principal. This commission is at an agreed rate calculated upon the gross amount of the sales, and the consignee takes credit for it by debiting the Consignment Account in his books

Sales Journal.

and crediting his own Commission Account. After passing the commission through the Consignment Account the balance on the account will agree with the balance brought out on the Account Sales. If the consignee remits this balance by cheque on sending the Account Sales to his principal, he credits Bank and debits the Consignment Account; if he send his bill for the amount of the balance he passes that bill through his Bills Payable Book and posts it from there to the debit of the Consignment Account; but if he send neither cheque nor bill along with the Account Sales he must pass an entry through his Journal crediting his principal's personal account with the amount of the balance on the Account Sales and debiting the Consignment Account, this latter account being thereby squared.

Should the consignee accept the consignor's draft upon him against the consignment at the time the consignment is made, he credits Bills Payable and debits the personal account of the consignor; and when the whole of the goods have been sold he transfers the balance of the Consignment Account to the consignor's personal account and then remits to him the balance still due or carries such balance over pending another transaction of a similar nature.

Drafts.

When the consignee balances his books for his financial year he must not take the consigned goods into his balance sheet as an asset; they are not his property. He simply carries down the balance of the Consignment Account as if it were a personal account, any Dr. balance on it representing how much the consignment owes him for outlays, and a Cr. balance showing by how much his sales to date exceed his outlays in connection with the consignment; a Dr. balance would thus be an asset Cr. balance a liability.

Joint Accounts or Joint Adventure Accounts.

A joint adventure is a temporary partnership entered into by two or more parties for the conduct of some special undertaking or adventure. The interest of the parties in the profit or loss of the adventure are presumed to be equal in the absence of express agreement to the contrary. The adventure

may be in connection with a consignment of a quantity of goods, a speculation in securities, the erection of buildings, or any other purpose having profit for its object, the parties only being partners for the particular course of dealing for which the agreement has been entered into. Except in special circumstances it is only to adventures for speculation in goods which are to be purchased for the joint account and consigned to some special destination for sale there that counting-house methods are applied, as such transactions run concurrently with the ordinary commercial dealings of the house; the other classes of adventure are usually conducted personally by the parties. In this commercial class of adventure one of the parties to the adventure generally assumes the management of the undertaking. He must keep strict account of his dealings, and when the adventure has been closed he prepares a Profit and Loss Account showing the profit or loss on the deal and how that profit or loss is to be allocated among the parties.

J/A Account.

The simplest plan of account-keeping for a joint adventure is for the managing partner to keep one account for the adventure and another for each of his co-adventurers. The Adventure Account is in form exactly similar to a consignment account as it appears in the books of the agent, and the accounts of the other partners in the transaction are ordinary personal accounts. Assume a simple case of two parties only. The first transaction which the managing partner may have is his receiving cash from his partner in the adventure with which to purchase the goods to be consigned; the entry for this transaction is Cash Dr. to the account of the partner advancing the capital. When the goods are purchased for cash the entry is Adventure Account Dr. to Cash, and as the miscellaneous charges for freight, insurance, and other items incident to the consignment of the goods are paid Cash is credited and the Adventure Account debited. Provision will probably have been made in the agreement between the parties for the partner advancing the capital for the adventure to be credited with interest thereon, and the partner managing the adventure to receive the usual agent's commission for management. These adjustments are

carried through the accounts in the same way as interest on capital and salaries to partners in partnership accounts; that is, the Adventure Account, which is the Profit and Loss Account of the undertaking, is to be debited with the interest on the capital advanced and also with the commission or salary for management, and with regard to the interest the account of the partner making the advance of capital is credited with the interest to which he has become entitled, and the managing partner credits his own Commission Account for the commission or salary he has become entitled to. The balance of profit or loss is then shared between the partners in the agreed-on proportions, the outside partner having his account credited with his share, and the managing partner transferring his share to his own Profit and Loss Account. The balance which would then stand on the personal account of the outside partner would represent the amount of capital he advanced at the outset plus interest thereon, and also plus his share of profit or minus his share of loss.

Adjustments between Parties.

If both parties have had transactions on Joint Account—say one at home, the other abroad—it is necessary before a settlement of accounts can be made that one party render to the other a Statement of his dealings with the joint adventure funds. The party receiving the Statement would debit Joint Adventure account with his co-adventurer's outlays and credit that party's account with these, and he would credit Joint Adventure account with all receipts of his co-adventurer and debit that party's account therewith. It might happen in such a case that the other party had to pay to instead of receiving from the party keeping the accounts the balance on his account at the close of the transactions. If one of the parties take over a quantity of the joint-account goods his account must be debited and Joint Adventure account credited with their value.

It is really very seldom that in actual business an advance of cash is made by the partner financing the adventure, more often the managing partner draws on the financing partner for the amount required for the purchase of the goods to be consigned, and the bill is discounted. In such a transaction we

have the managing partner (call him B) drawing on the financing partner (call him A). This bill is in B's books a bill receivable, and A the individual is the giver; the entry would accordingly be Bills Receivable Dr. to A. When the bill is discounted we have Cash or Bank Dr. for the net proceeds of the bill, and the Adventure Account Dr. for the discount charged thereon, and Bills Receivable Account creditor for the gross amount of the bill discounted. The other transactions go on as before, and eventually the bill matures. If A meets the bill there is of course no entry to be made in B's books therefor in connection with the adventure, as A was previously credited as the giver of the amount contained in the bill, but if, as is commonly understood, B is to take up the bill with the adventure funds in hand from the realisation of the consignment the payment is being made not on behalf of the adventure but on A's behalf; and the entry is therefore Cash or Bank Cr. for the payment and A Dr. for the amount of his acceptance which is being taken up.

The exact terms on which the adventure is entered into between the partners must be clearly set forth in the contract between them, but it should be observed by the student that in the instance supposed in the foregoing illustration A did not actually advance any capital, but merely put his name to the bill, and when the bill was discounted the discount was charged to the Adventure Account. Obviously, then, A has no claim on the adventure in respect of interest, but if he had a claim under the agreement for interest on the capital supplied by him he must be debited with the discount charged on the bill instead of its being charged to the adventure. The same result on this last assumption would be attained by B merely crediting A with the net proceeds of the bill when discounted, instead of crediting him with the gross amount of the bill and debiting him with the discount thereon.

V.—MANUFACTURERS' ACCOUNTING

In the Trading Account of a concern which merely buys and sells goods the Gross Profit represents the margin by which the selling price exceeds the cost price of the goods turned over, and the cost price in such a case consists of only one element—the purchase price of the goods. In a manufacturing concern we find that our definition of Gross Profit still remains true, it is still the margin by which the selling price exceeds the cost price, but the cost price in this case is made up of many factors, such as material, workmen's wages, power for machinery, tools, &c. It is clear then that in framing the accounts of a manufacturing business these items, or such others as may constitute the cost of the articles sold, must be debited to the Trading Account or its equivalent to bring out the Gross Profit. We must first decide what factors constitute the cost in any particular case, and then evolve a system of record to meet the circumstances. Ordinarily we have cost comprising the three main heads—(1) Material; (2) Workmen's Wages; (3) Establishment Charges. These elements of cost must be separately discussed.

1. *Material.*—A separate account must be kept for each of the factors of cost. The Material Account opens with the Stock of raw material on hand at the beginning of the period at its debit. It is further debited with the purchases of such material throughout the period, is credited with the stock of material on hand at the close of the accounts, and the balance of the

account then represents the cost of the material actually used in the period's manufacture. Thus—

Material Account.

Dr.						*Cr.*			
July 1. To Stock at this date .	. £381	12	6		Dec. 31. By Stock at this date .	. £366	2	8	
„ 31. „ Purchases for month .	72	11	4		„ Manufacturing Account for cost of material used.	. 358	7	4	
Aug. 31. Do. .	38	6	9						
Sep. 30. Do. .	51	13	2						
Oct. 31. Do. .	26	10	11						
Nov. 30. Do. .	83	17	3						
Dec. 31. Do. .	69	18	1						
	£724	10	0			£724	10	0	
Jan. 1. To Stock at this date .	. £366	2	8						

If it were considered necessary in any particular case to divide the Material Account into subheads this could readily be done by raising headings for the necessary subdivisions and keeping the accounts on the same principles as are applied to the foregoing general account. Where a subdivision of Material Account has been made the Manufacturing Account would have the subheads enumerated, with the cost of each, instead of but one entry for the whole cost of material, as would be the case when one general Material Account has been kept.

2. *Workmen's Wages.*—The first point to be noticed by the student in this connection is the important distinction between workmen's wages and the wages of salesmen and clerks. The former class is termed Productive Wages, the latter Unproductive, Distributive, or General Wages. Productive Wages are an element of cost, general wages are rather a charge upon the Gross Profit earned. A Productive Wages Account must be kept, apart from the General Wages Account, and its balance transferred at the close of the books to Manufacturing Account. Thus—

Productive Wages Account.

Dr.					*Cr.*			
July 8. To Cash .	. £27	10	0	Dec. 31. By Manufacturing Account for cost of labour	£310	5	0
„ 22. „ Do. .	. 27	15	0					
Aug. 7. „ Do. .	. 26	13	4					
„ 21. „ Do. .	. 27	2	6					
Etc. „ Do. .	.							
„ „ Do. .	.							
	£310	5	0		£310	5	0	

If at the close of the books there be a portion of the current week or fortnight's wages accrued and not payable until the ensuing pay-day, the proper method of treatment is to debit the sum so accrued to the expiring period's account and carry it down to the credit of the new period's account.

3. *Establishment Charges.*—Under this general head there are included the rent, rates, and other charges on the workshop or factory used in the production of the goods, the engine-room expenses or cost of electric current for power, the cost of upkeep of plant and tools, the cost of superintendence of the manufacture, and similar items. These charges are inseparable from the conduct of a manufacturing business, and as they are incurred in the production, not the sale, of the goods they are rightly regarded as elements in the cost. Suitable Ledger headings are raised for the different classes of such charges, so as to group them in such a way as to convey a maximum of information with a minimum of labour in recording them. It depends on the nature of the business and also on its particular circumstances what subdivisions of these charges are most convenient, but the following are suggested as indicating the general lines of such classification, viz.:—Factory Upkeep (for rent, rates, and other charges connected with the use of the factory buildings), Power, Heating and Lighting (for motive power for plant, fuel for heating, and artificial light; these items are commonly inseparable), Plant and Tools, General Factory Wages, General Factory Charges.

The Manufacturing Account would then appear as follows:—

Manufacturing Account.

Dr.			Cr.			
Dec. 31.	To Cost of Material used .	£358 7 4	Dec. 31.	By Sales . .		£1440 5 5
	„ Cost of Labour .	310 5 0		„ Increase of Stock during half-year:—		
	„ Power, Heating, & Lighting .	42 3 8		Value at 31st Dec. .	£563 11 2	
	„ Factory upkeep .	87 16 3		Value at 1st July .	517 6 5	46 4 9
	„ Depreciation of Plant and Tools and renewals	26 12 1				
	„ General Factory Charges	102 17 10				
		£928 2 2				
	„ Gross Profit .	558 8 0				
		£1486 10 2				£1486 10 2

In this example the total cost of the manufactured articles is shown on the Dr. side, while the Sales and increase of the Stock of finished goods are put on the Cr. side.

Stocks. The effect of thus treating the stock is of course the same as debiting the stock at the beginning of the half-year and crediting the stock at the end. The resulting Gross Profit is carried to the credit of Profit and Loss Account in the usual way. The Stock on hand in a manufacturing business consists usually of three classes, for which the separate totals must be shown in the Stock Sheets:—1. raw materials; 2. partly-worked goods, and 3. finished goods. The first class must be taken at cost price at which they were invoiced, and the value is treated through the Material Account or its subdivisions, as previously explained, not through the Manufacturing Account as Stock on

hand. The second class, the partly-worked goods or "work in progress," as it is termed, should be valued at the cost in material and wages, plus a percentage or proportion in respect of the factory and general establishment charges up to the stage at which it is at stock-taking. The third class, the finished goods, should be included in the stock sheets at the cost of manufacture, including the proportion for general establishment expenditure. Great care must be taken to see that the probable profit on the sale of this class of stock is not anticipated by overvaluing for stock-taking purposes. The values of the stock of the second and third classes—the work in progress and finished goods—are lumped and carried down on the Manufacturing Account as shown above. The Cr. side of the account should give the actual output for the period without including that part of the contract price on unfinished contracts and manufactures which represents the profit-margin estimated for. In the foregoing example the Sales item of £1440, 5s. 5d. represents the price of goods and work charged up to customers within the half-year. Of that figure a part was for work in course of completion at 1st July, which has now been completed and invoiced in full in the £1440, 5s. 5d. From that half-year Sales total there is accordingly deducted the work in progress at 1st July, which is so deducted in the subtraction of the 1st July Stock-valuation of £517, 6s. 5d. in which that work in progress was included. The remainder of the July Stock Valuation was finished goods. The corresponding Stock Valuation at 31st December was £563, 11s. 2d., so that to 31st December, in addition to completing and invoicing to

customers manufactures valued at . . .	£1440 5 5
there was work in progress and other goods finished valued at	563 11 2
an aggregate value of	£2003 16 7
of which there was on hand finished and in progress at the beginning of the half-year . . .	517 6 5
making the half-year's actual output . . .	£1486 10 2

If the stock at the close had shown a decrease as compared

with the opening valuation the reasoning would still have been the same, and the conclusion would have been that the work in progress (since completed) and finished goods in hand at the beginning which have been invoiced to customers within the half-year had not at the close of the period been replaced by other finished or partly manufactured goods of at least as great value.

When a factory is run in conjunction with a warehouse it is always desirable that the result of the operations in both houses should be capable of ascertainment independently.

Manufacturing and Trading Profits.

There are two methods of accounting between the two departments, only one of which attains this end: *First*, the factory may be conducted as an independent concern showing its costs in its own Manufacturing Account, and taking credit therein at market prices for the manufactured goods sent to the warehouse. The warehouse Goods Account in such case has such transfers at its debit at the same figures. The result of the Factory's work is the profit or loss brought out on its Manufacturing Account; the result of the Warehouse's trading is the profit or loss brought out in its Profit and Loss Account in the ordinary way. *Second*, the factory and warehouse may be regarded as one concern, in which case the Manufacturing Account has at the debit the whole costs of manufacture after crediting the closing stocks of material and stores, and the balance on this account is transferred from its debit to the Dr. side of the Goods Account to be kept for the warehouse as the cost of goods supplied to that department. In other words, the cost of the goods supplied by the factory to the warehouse is not the market rate, as in the first case, but simply the cost of production in that factory. When the accounting is so conducted the Gross Profit on the Goods Account kept for the warehouse represents the profit or loss on the manufacture combined with the gross earnings on the trading. The obvious disadvantage of this second method is that the result of the trading is not ascertainable apart from the manufacturing result, whereas it might be found on a strict accounting between the two departments that it would be more profitable to stock the warehouse from other manufacturers at market prices than to continue running the firm's own factory.

Depreciation.

One of the most difficult and important questions falling to be decided by the manufacturer is the amount of depreciation to be written off any of his plant, machinery, tools, buildings, or other wasting assets. The question also arises in the course of a trader's business, but it is in his case capable of easier solution than in the manufacturer's, and the amount involved in the problem is much less in the case of the trader.

Depreciation is the diminution in the value of an Asset. The question is best discussed from the point of view of a manufacturer seeking to solve the problem in relation to his machinery and plant. The manufacturer must also reckon on possible obsolescence of his machinery or processes, but the risk of special machinery employed being superseded by new inventions tending to throw out the old plant cannot be valued and provided for, as there is no data for any assumed obsolescence becoming actual in any period. We must therefore discuss the question solely with reference to depreciation by wear and tear in use, and the considerations educed in such discussion will enable the student himself to deal with the more complex problems which he may encounter in particular cases.

Let us assume the existence of a machine which cost us £100 a year ago, and in ascertaining our profit for the year just closed we have to settle the amount of depreciation to be charged on the profits for the past year. Certainly the machine has

Methods of Writing Down.

depreciated, but it is impossible to put an exact money value on such depreciation year by year. We must therefore adopt some method which will enable us to carry down as an asset year after year the approximate value of that machine as a profit-earning factor in the business, and such method must result in our charging against each year's profits a sum proportionate to the yield of that machine during the respective years. The student will admit that, as the machine is used in the manufacture of the goods we produce, the depreciation of the machine forms an element of the cost of manufacture. If we have data for assuming that the supposed machine will last five years, that is, it has a "life" of 5 years, it is clear we must

write off the cost (£100) in five years. The following Tabular comparison shows the effect of the application of the two methods most commonly employed:—

	1st method (20 per cent. on cost).	2nd method (20 per cent. on written-down value).
Cost of machine . . .	£100 0 0	£100 0 0
1st year's charge . .	20 0 0	20 0 0
Asset at end of 1st year .	£80 0 0	£80 0 0
2nd year's charge . .	20 0 0	16 0 0
Asset at end of 2nd year .	£60 0 0	£64 0 0
3rd year's charge . .	20 0 0	12 16 0
Asset at end of 3rd year .	£40 0 0	£51 4 0
4th year's charge . .	20 0 0	10 4 10
Asset at end of 4th year .	£20 0 0	£40 19 2
5th year's charge . .	20 0 0	8 3 10
Standing on the books at end of 5th year . . .	£0 0 0	£32 15 4

As the machine was estimated to have a "life" of five years only, it ought to be wholly written off in that period. The first method shown secures this result. whereas the second has a large balance of the machine's cost left on the books when there is no asset representing this value. To write off an equal instalment throughout the life of the asset as is done by the first method is grossly inequitable as between the different years' profits. The machine is most efficient in the earlier years, and its efficiency decreases year by year. As the yield of the machine diminishes through its decreasing efficiency, the outlay for its upkeep by repairs is increasing, and we accordingly have two forces operating a reduction of profits, a decreasing yield, and an increasing charge for upkeep. To compensate for this obvious inequity a heavier depreciation should be charged to the earlier years, when the efficiency is greatest and the repairs-charge lightest.

A third method, which combines the final result of the first method with the graduated charges of the second, is as follows:—

Suppose that the machine has cost, say, £120, and will at the end of its five years' "life" have a residual value of £20. We desire to find what percentage of the written-down value must be written off each year to reduce the book value to the residual value within the five years' period. The formula is—

$100\left\{1-\left(\frac{R}{V}\right)^{\frac{1}{n}}\right\}$, in which R = residual value, V = Present Value, and n the number of years until V becomes R. Substituting our figures we have,

$100\left\{1-\left(\frac{20}{120}\right)^{\frac{1}{5}}\right\}=30{\cdot}13$, and the schedule in the same form as given for the first two methods would be:—

Cost of machine = V	£120 0 0
1st year's charge	36 3 0
Asset at end of 1st year . . .	£83 17 0
2nd year's charge	25 5 0
Asset at end of 2nd year . . .	£58 12 0
3rd year's charge	17 13 0
Asset at end of 3rd year . . .	£40 19 0
4th year's charge	12 7 0
Asset at end of 4th year . . .	£28 12 0
5th year's charge	8 12 0
Asset at end of 5th year = R . .	£20 0 0

In considering the reducing charge under this method there must be kept in view the possibly diminishing output of the machine and the certainly increasing repairs-charge.

The whole question of the amount of depreciation to be written off in any year is one of circumstances to which a little experience will enable the student to assign their proper value. The leading principles to be followed are, first, that the value of the asset carried forward on the account must be as near as possible its value-in-use at the date of the Balance Sheet, and second, the amount written off to bring down the book-value to this figure should be (as compared with the

amount written off in the other years) a fair proportionate charge upon the earnings for use during the year.

Having arrived at the amount to be written off the asset, the next question is how this amount should be treated in the business books. There are two methods. In the first case we assume that the amount which we propose to write off for the year's depreciation is as accurate as may be, and we pass an entry through the books giving effect to our decision, debiting Profit and Loss Account and crediting the account of the asset concerned. Thus:—

Book Entries.

Special Plant Account.

Jan. 3. To Cash for cost of machine	£100 0 0	Dec. 31. By Profit and Loss Account for depreciation .	£20 0 0
		" Balance, being value of machine carried down .	80 0 0
	£100 0 0		£100 0 0
Jan. 1. To Balance brought down .	£80 0 0		

This shows the amount of the depreciation which we have resolved to write off actually passed through the Special Plant Account, writing down the value of the machine, so that in the Balance Sheet prepared at the close of the books the reduced value of £80 would appear. If there are a number of depreciation items to be passed through the books a Depreciation Account should be opened for them, and such account would be closed into the Profit and Loss Account as an ordinary nominal account.

Depreciation Reserve.

The second method is this: It is seldom possible, in the case especially of a manufacturing business, to estimate with perfect accuracy the extent of the depreciation which has to be written off the wasting assets, and it is not therefore always desirable that the

entries made for the annual depreciation-charge should be passed through the books with the finality of the foregoing example. On this consideration it is certainly safest for the assets to be periodically re-valued, and in the years intervening between the valuations an estimated amount should be provided for depreciation. At the beginning the accounts would of course show the purchase price of the asset, and it might be resolved to re-value it every third or fifth year. The amount of the depreciation for the first and second years would be estimated, and the entry passed through the books would be Profit and Loss Account Dr. to Depreciation Reserve Account. This Depreciation Reserve Account would in this way have the estimated depreciation for the first and second years put to its credit, and, on the re-valuation taking place at the end of the third year, the value of the asset so ascertained would be carried down on the asset account, and the balance of the asset account (which balance would represent the depreciation for the three years) would be written in to the Depreciation Reserve Account. The balance on this Depreciation Reserve Account would then be written off to Profit and Loss Account as the depreciation-charge for the third year necessary to bring down the book-value of the asset to the amount of the valuation. Thus:—

Special Plant Account.

1909. Jan. 3. To Cash for cost of machine	£100 0 0	1911. Dec. 31. By Balance, being the amount of valuation at this date	£55 0 0
		" Depreciation Reserve Account for the ascertained depreciation hereon .	45 0 0
	£100 0 0		£100 0 0
1912. Jan. 1. To Balance .	£55 0 0		

Depreciation Reserve Account.

Date	Particulars	Amount	Date	Particulars	Amount
1911. Dec. 31.	To Special Plant Account for the ascertained depreciation to this date	£45 0 0	1909. Dec. 31.	By Profit and Loss Account estimated charge for depreciation on special plant for year .	£20 0 0
			1910. Dec. 31.	„ Do. for Do.	20 0 0
			1911. Dec. 31	„ Do. for balance of depreciation to be written off to date	5 0 0
		£45 0 0			£45 0 0

The principle of the operation will be followed in the above illustration, although the bare facts of the assumed case are not parallel to actual business. The student should observe that the Special Plant Account has the original cost of the machine standing at its debit unaltered until the re-valuation takes place. During this period the accumulating provision for depreciation stands at the credit of the Depreciation Reserve Account. The Special Plant Account balance, being a debit, would appear in the Balance Sheet as an asset, and conversely, the Depreciation Reserve Account balance being a credit might appear as a liability. The correct way to state it, however, is to deduct the amount of the Depreciation Reserve provided for the writing-down of a specific asset from the asset itself in the Balance Sheet. This method of estimating the depreciation-charge for so many years and then having a re-valuation to test the accuracy of the estimate, results in the account being periodically adjusted.

It is a comparatively simple matter to consider and provide for the depreciation of a specific asset, but ordinarily the ques-

tion is complicated by the addition of other assets from time to time, so that new and old assets appear together in the same account. Especially is this the case with such accounts as Fittings and Furnishings, in which the property is continually being added to. The common practice is to write off a fixed percentage from the value standing on the books from year to year. The account in such circumstances would appear as follows:—

On Accumulated Assets.

Fittings and Furnishings Account.

Date	Particulars	Amount	Date	Particulars	Amount
Jan. 3.	To Cash being Purchase price .	£200 0 0	Dec. 31.	By Profit and Loss for depreciation at 10 per cent.	£20 0 0
				„ Balance .	180 0 0
		£200 0 0			£200 0 0
Jan. 1.	To Balance .	£180 0 0	Dec. 31.	By Profit and Loss for depreciation at 10 per cent.	£19 0 0
Feb. 10.	„ Cash for new chairs	10 0 0		„ Balance .	171 0 0
		£190 0 0			£190 0 0
Jan. 1.	To Balance .	£171 0 0			

The rate of depreciation provided for here is, it will be observed, a fixed percentage on the reducing value of the items debited to the account. Each year is only chargeable with that percentage calculated on the value of the furniture brought forward from the previous year plus the new items added to the account during the year. The obvious result, as previously demonstrated, is that the whole of the first cost is never written off although the articles are worn out and replaced, but this error is largely counteracted by the high percentage usually adopted when writing down by this method. In any event, it must be kept in view that a charge for depreciation is at best only an estimate of the diminution of the value, and it is the value-in-use, *i.e.* the value in the special circumstances and in a going

concern, and not break-up value, that is to be carried forward as an asset.

One idea concerning depreciation which is very prevalent in some circles, and which the student must be careful to reject, is that depreciation chargeable for any period can vary with the profit against which it can be written. Some concerns charge a heavy depreciation in good years and make a very light charge or none at all in bad years, thus treating the question as if it were one of discretion, whereas depreciation is a fact and forms a real charge against revenue whether profit is the ultimate result of the period's work or not. Depreciation is a factor in the cost of the undertaking, and an appropriate allowance must be made for it whatever the Profit and Loss Account shows by way of profit or loss.

Cost Accounts.

Cost Accounts may be defined as a system of accounts which shows the cost of the production of articles or groups of articles, or the cost of any piece of work or any of the separate processes employed in production. We have already seen that instead of a manufacturer regarding the purchase-price of goods as their cost he has to include as elements of cost the purchase-price of the materials, the wages of the workmen who produce the articles sold, and also certain classes of expenditure connected with the upkeep of the factory. The account embracing such items we denominated "Manufacturing Account," and the Dr. side showed the whole cost of the production consisting of the cost of material used, the wages paid and incurred, and the factory charges, while the Cr. side showed the output; in other words, the Manufacturing Account is the centre on which are focussed all the factors constituting the cost of production, and against this cost is shown the gross return for the products sold, the difference on the account obviously being the gross profit. When we come to the discussion of Cost Accounts, however, we devote our attention to the converse problem; we do not seek to aggregate the elements of cost but to separate them, to analyse them

and apportion them among the contracts or articles completed and in course of completion. In this way we seek to ascertain the cost of each contract or article or class of articles.

Objects of Costing.

The advantages of such information regarding the cost of manufacture may be classed under three general heads, past, present, and future.

Firstly. Cost Accounts show past results; they localise profits and losses on work undertaken in the past. The gross profit brought out in the Manufacturing Account may be the difference between enormous profits on one class of work and a loss on another class. All that the Manufacturing Account tells us is whether in the aggregate a gross profit has been earned and how much; it tells us nothing of the source of such profit, and it does not reveal whether there has been a loss on certain sections of the work undertaken. A costing system, however, shows approximately the result in profit or loss of every piece of work executed, and in this way the result in gross profit shown in the Manufacturing Account is supplemented and amplified. In fact a complete costing system goes further than this; the Profit and Loss Account expenditure is also allocated over the work done during the financial period, and it is thus seen whether each order has borne its proportionate share of the general expenditure and yielded a reasonable profit thereafter. The final result of such a system of costs would thus approximately agree with the Net Profit brought out in the Profit and Loss Account.

Secondly. During its operation the costing system exercises a deterrent effect on employees disposed to dishonesty, and reveals any falsification of the books by the disagreement of the aggregate results shown in the commercial books with the details shown on the cost accounts. As the two systems of account are independent of each other, one necessarily constitutes a check upon the other, for they record the same facts, one in lump and the other in a dissected form. The agreement between the two systems is not absolute, but is sufficiently approximate to throw up any wide divergence between the two results. Also, as it is necessary in the keeping of a cost system to analyse the wages and apportion them between the jobs in progress, this has a tendency to stimulate workmen to industry,

in case they suffer in contrast with the results shown by their more skilful or industrious fellow-workmen.

Thirdly. The future benefit of a cost system is that, as the results of past work can be minutely ascertained and the profit or loss on each class of undertaking localised, much valuable information is at the disposal of the manufacturer for his guidance in estimating for similar contracts. He knows exactly what the cost of similar work or processes has been in the past, and he is therefore in a position to tender quite confidently for the proposed work at such a sum as would yield him a reasonable profit. Without such a system any estimate of cost must be more or less a leap in the dark. It is really necessary for the manufacturer to know what price is required to cover the cost of production and when profit begins to emerge; failing this he may be more intent on under-cutting his competitors than in working profitably, and the result to be looked for is that he secures the contract on terms spelling a loss instead of a profit.

Analysis of Price.

The student will get the best idea of the purposes of costing from a glance at the following analysis of the selling-price of a completed article:—

1. Material used in construction.
2. Wages of workmen employed on construction.
3. Use and upkeep of the workshop buildings, plant, and tools, foremen's wages, and such other expenditure as is necessary to the manufacture of the article.
4. General charges connected with the administration and financing of the business and the cost of distributing the finished goods
5. Any balance remaining is profit; any shortage is the amount by which the price received fails to pay the cost of manufacture and sale.

Items 1, 2, and 3 taken together form what is called "Prime Cost." When this prime cost has added to it its share of the administration and selling expenses we have the "Total Cost." The prime cost is the first cost of production, the total cost is

the money price of all factors necessary to organise the business and produce the saleable commodity. One authoritative work on the subject defines "Prime Cost" as the cost in wages and material only, and when the other expenses of production are added thereto the "Cost of Production" is given. Again, Items 1 and 2 are the "Direct Cost," 3 and 4 the "Indirect Cost," and these two together the "Total Cost." The following illustration shows the order of charge of the various outlays in production:—

The selling-price of an article is . . .		£100 0 0
The material used in construction cost	£50 0 0	
And the wages paid to the workmen employed on it amounted to .	25 0 0	
Cost in material and wages .	£75 0 0	
The proportion of the workshop charges effeiring to this job, calculated at 20 per cent. on wages .	5 0 0	
Showing Prime Cost . .		80 0 0
And the Gross Profit . .		£20 0 0
A proportion of the general administrative, distributive, and financing charges, calculated at 10 per cent. on material and wages . .		7 10 0
Leaving as Net Profit on the manufacture and sale		£12 10 0

No hard and fast method of treatment can be laid down for any system of cost accounts; every business must be a law unto itself in this matter. The nature of the manufacture engaged in and the magnitude and general circumstances of the business must all receive due consideration in the establishment of the system, and it is therefore only possible to discuss certain principles of general application, the student thereafter trusting to his own insight into the requirements of the business to evolve suitable costing arrangements. Begin with a very simple method of recording

First Principles.

costs, and, as the details of that become familiar, improvements will suggest themselves as natural developments that should be introduced. It is seldom advisable to institute an elaborate system all at once; it is necessary to educate the whole staff of employees, including office staff, foremen, and workmen, up to fulfilling their respective parts, and this must be accomplished gradually. Assuming that the desirability of instituting a costing system is conceded, it is a question for the particular case what special features the proposed system must embody. The general lines which any arrangement must follow will now be set down, adopting for simplicity in illustration of root principles the case of a concern which practically confines itself to contracts which are all individually costed. Every business which pays productive wages must cost somehow to fix the prices to be charged up for the work, and although the costing system may be far from complete, its principles may be sound and the results attained fairly satisfactory; but so long as it is incomplete there must remain the possibility of error of principle or in the application of principle, no check being available. Nevertheless, certain classes of works would find a complete system burdensome and useless, and the separate costing of standard articles or processes would then be undertaken from time to time to verify working estimates of prices. In other cases the work to be costed would be of such a character as to lend itself advantageously to the costing of sections or parts of the main contract, especially if the work was undertaken on a specification with the sections separately priced out. Again, articles may be costed in groups, and the cost of each ascertained therefrom and expressed per unit of manufacture, whether per article, per ton, per barrel, or otherwise according to the custom of the trade. But none of these special considerations affect the general principles to be examined by the student. The kind of business conducted governs the costing arrangements, the jobbing tradesman charging out his time and materials in detail in his Customers' Ledger and adding as oncost an estimated proportion verified by his yearly Profit and Loss Account, while the contractor for large undertakings will cost up each one systematically with his Cost Ledgers on double entry. The aim in view is to record in some form

the cost of each contract or manufactured article or process in material, wages, and other factors in its cost. Clearly these items in every case divide themselves into two groups: First, the material used and wages actually expended on the particular undertaking, for these items are capable of ascertainment; and second, the proportion of the general expenses of the business which that particular job should carry. This cannot be ascertained like the other items, and is therefore laid on as a proportion. This second class lends itself to subdivision into direct expenses of production, that is, expenses of manufacture, and the expenses of administration and distribution. The expenses of manufacture may also be further divided into two groups where the factory consists of separate departments or workshops. There would be the expenses of manufacture applicable to the particular workshop or department in which the job was being executed, and there would also be the expenses of manufacture common to the factory as a whole. The special department expenses are spoken of as Shop or Departmental Oncosts and the expenses common to the whole factory are known as Factory Oncosts. The expenses of administration and distribution are termed General Establishment Charges. We accordingly have in a factory not divided into departments or shops the following groups of costs :—

1. Material and Wages directly applied to the job.
2. A share of the Factory Oncosts.
3. A share of the General Establishment Charges.

Cost Ledger.

The ultimate destination of every entry in any of the books belonging to the costing system, as in the commercial system, is the Ledger. The Cost Ledger is the book which contains the separate accounts for each of the contracts, articles, or groups of articles to be costed, these accounts being debited with all that they receive in the way of outlay and credited with the selling or contract price. Every order or separate section of an order receives a number by which it is known throughout the process of manufacture, and the ledger account relating to its cost bears this number as its distinctive mark.

RULING OF COST LEDGER.

Order No.______ *General Description of Order.*

Dr. *Cr.*

Item.	Fol.	Material.			Wages.	Outlays.	Total Cost.	Item.	Fol.	Material.			Price.
		Quantity. T. C. Q. L.	Rate.	Amt.						Quantity. T. C. Q. L.	Rate.	Amt.	

The foregoing form explains itself. The object in having the Dr. side analysed is to yield the material and wages details for the purpose of laying on the oncost. The Dr. material columns are for the issues of material for the order, and the Cr. material columns are for returns of overdrawn stores. At balancing the Cr. material total should be carried over and taken from the corresponding Dr. total so as to bring out the net cost of material used on the order. In addition to the separate accounts for the contracts, jobs, or articles there are also to be found in this Cost Ledger accounts for Stores, Special Purchases, Stock, and others of a like nature, and also a Manufacturing Account which corresponds to the Manu-

facturing Account in the commercial books. The purpose of these general accounts will be explained in the treatment of the separate books of original entry in the costing system.

It is to be remembered that the costing system, although to some extent interwoven with the commercial book-keeping system to economise clerical labour, is complete in itself, and is on double entry principles.

Purchases.

1. *Material.*—A distinction is to be noted here by the student, namely, that worked goods are known as Stock, while unworked material is known as Stores. It is pointed out above that the value of the stock is carried down on the Manufacturing Account, while the value of the stores is carried down on the Material Account. All invoices received for purchases are for three main classes—stores, items specially ordered for some particular contract, and plant and tools. The Invoice Book should be ruled to keep these classes quite distinct, that is, there should be separate columns for each of these heads. As the invoices are received they are copied into the Invoice Book or merely an abstract of them written into it and the invoice itself filed away for reference. The separate entries in the Invoice Book are credited to the sellers of the goods, and at the end of the month the totals are debited to the Stores, Special Purchases, and Plant accounts in the General Ledger. This keeps the commercial books all right, and we have now to make some record of these same facts so far as they relate to the costing arrangements. All purchases of stores are passed into the custody of the storekeeper, and he has to keep an accurate record of all the stores he receives and issues. If it were desired to divide the raw material into a number of classes it would be necessary for the storekeeper to have a Stores Ledger containing an account for each of these classes, and the Invoice Book would require to have an analytical column for each of the subdivisions instead of only one Stores column. Assuming for the sake of the demonstration of the general principles that the stores are to be kept in one class only, the Stores column of the Invoice Book shows month by month the cost price of the stores purchased, and this accordingly falls to be debited to the Stores

Account in the General Ledger, as already shown. In the Cost Ledger an account is opened for Stores and another called General Ledger Account, and the monthly total of the Invoice Book Stores column is debited to this Stores account and credited to this General Ledger Account, thereby preserving the balance of the Cost Ledger. The Special Purchases of goods to be directly applied to some particular contract are best treated also through the storekeeper's department but kept quite distinct from the general stores. An account is opened in the Cost Ledger called Special Purchases Account. This account is debited with the monthly total of the Special Purchases column of the Invoice Book, and the General Ledger Account in the Cost Ledger is credited with the same total.

Issues.

The Invoice Book thus forms the basis of charge against the stores department for the different kinds of material bought in, and we have now to consider the issue of that material for use upon the contracts in process of fulfilment. A book is provided called "Stores Issued Book," which is in the costing system similar in its functions to the Day Book in the commercial system. It requires to be ruled with analytical columns for Stores and Special Purchases, extra columns being provided where further dissection is aimed at. When material is required for work in hand a written order is made out by a foreman giving the number of the contract for which stores have to be issued and details of quantities, &c.; this order is known as a Stores Warrant. The storekeeper hands over the material requisitioned and enters the issue in his Stores Issued Book, extending the price of the stores *at cost.* The items in this book are debited in the Cost Ledger to the accounts of the separate orders for which the stores were issued, and the monthly total is credited to Stores Account in the same ledger. The Special Purchases also are debited from the Stores Issued Book to the orders for which they were made, and the total of the column for the month is credited to the Special Purchases Account. It should be noted that this Special Purchases Account is debited from the Invoice Book with the cost of the special material ordered for particular contracts, and is credited when such material is actually issued

for use on the contracts, and as the entries are both made at the cost price, the Special Purchases Account in the Cost Ledger should have no balance on it unless some part of the special purchases still awaits issue.

Returns to Store.

It sometimes happens that a greater quantity of stores is drawn for an order than is actually required, and provision must therefore be made for the overdrawn stores being returned to the storekeeper. A Stores Returns Book fulfils this purpose. It is written up from the Store Debit Notes, which contain particulars of the returns. It must be ruled exactly the same as the Stores Issued Book, and the postings are the reverse of those of the Stores Issued Book; thus, the separate items in the Stores Returns Book are credited to the orders for which the stores were originally drawn, and the monthly totals of the columns are debited to Stores Account or Special Purchases Account, as the case may be.

Stores Account.

The Stores Account being thus debited from the Invoice Book monthly with stores purchased, and also debited from the Stores Returns Book monthly with the overdrawn stores returned to the storekeeper, and credited from the Stores Issued Book monthly with the cost price of the stores issued for use on orders, the account itself should have as its balance the value of the stores on hand. The Stores Account in this respect is like a cash account, it is debited with the stores coming in and credited with the stores going out, and obviously as the two sides are written up on the same price-level the excess of the Dr. side over the Cr. must be the value of stores still unissued. The inventory of stores on hand should agree with this balance, not absolutely on account of fractional differences and reasonable wastage, but the agreement should be sufficiently accurate to reveal any error in the records or shortage in the stock of material.

Productive Wages.

2. *Wages.*—The second important element in the cost of production is the price of labour. It is only the productive wages which are charged up periodically in the manner hereafter explained, the wages of foremen, labourers, timekeepers, and others employed for the general benefit in organisation and at the call of skilled

men are to be considered as more of the nature of an oncost, something partaking more of the character of a general expense than as being directly applied to the production of any commodity or the execution of an order. It is essential that two Wages accounts be kept, a Productive Wages Account for wages of labour spent directly upon orders, and a General Wages Account for wages of superintendence, labouring, and organisation. Commonly workmen's wages are payable weekly or fortnightly, and the Wages Book shows the details of the lump sum which is credited in the Cash Book on pay days and posted from thence to the debit of Productive Wages Account. Every workman engaged on the orders in hand keeps a time-book or time-sheet in which he records the number of the order and the part of the work on which engaged, and the time occupied in each operation. These time-books or time-sheets show which orders have to be charged with the wages paid, and from the information thus at hand an analysis is made in a Wages Allocation Book. From this analysis each order is debited with its weekly or fortnightly total, and the aggregate of the Wages then paid is credited to the Wages Account kept in the Cost Ledger.

3. *Factory Oncosts.*—This term has been applied to those items which form a part of the cost of manufacture, but are not directly applied to the orders like material and wages. This charge commonly consists of such items as the rent and rates and upkeep of the works-buildings; the cost of supplying power, heating and lighting; the upkeep, renewal, and depreciation of plant and tools; the wages of foremen, labourers, and time-keeper; and similar items which vary in their character according to the nature of the business. These items are all recorded in the nominal accounts kept in the General Ledger which forms a part of the commercial book-keeping system. The past experience of the business must be drawn upon for the ascertainment of the ratio which those oncosts bear to the wages expended or the material used or both of these factors. It depends entirely on the character of the undertaking whether wages or material or both wages and material should be taken as the basis on which apportionment of the factory oncosts should be made to the orders charge-

Factory Charges.

able therewith. Apart from special circumstances pointing to the expediency of a different basis, the wages should be adopted as the standard, for it can be readily seen that rent, tools, superintendence, and unskilled labour vary rather with the wages spent on a contract than with the cost of the material going to its construction. Having ascertained what ratio the factory oncosts have in the past borne to the productive wages for the same period, it should ordinarily be expressed as a percentage, for facility in application to the current contracts. The charge in respect of the factory oncosts upon each of the orders completed is then calculated at this ascertained percentage, and the amounts so ascertained are debited to the accounts of the separate orders and credited to Factory Oncosts Account in the Cost Ledger. This percentage may require to be adjusted slightly after each balance of the books, especially in the earlier years of the operation of the costing system, so as to bring the percentage nearer to the actual experience of the business than was, perhaps, possible at first.

4. *General Establishment Charges.* — This term has been defined as embracing all the general expenses connected with the administration and financing of the business and the cost of distributing the finished goods. This class of charges really includes all the items which ordinarily fall into the business Profit and Loss Account and covers management salaries, including the office staff, office upkeep and supplies, and travellers' salaries, commissions, and expenses; carriage and freights; and discounts, interests, and bad debts. Past experience must be drawn upon also for the ascertainment of the ratio which such charges bear to the direct cost or other accepted basis of allocation. It is usual to apportion the general establishment expenses over the orders as a percentage on the material and wages, for it will be conceded that management, selling expenses, and financing vary with the cost of the material as well as with the cost of the labour spent upon it. The percentage which these profit and loss items have borne to the wages and material of the contracts of past years is first ascertained, and this percentage is then calculated on the wages and material charged up to each order, the amounts being debited to the accounts of the respective orders

Organisation, Distribution, Finance.

and credited to General Establishment Expenses Account in the Cost Ledger.

Thus far the costing system has a double entry for every item recorded.

Outlays.

Frequently cash payments of a miscellaneous nature are made on account of orders, such as travelling expenses of workmen, and these must be charged up to the cost account of the order on behalf of which they are made. In the commercial books the items are first entered at the Cr. of cash for the payment and from thence posted to the Dr. of an account specially kept for these charges. They are applicable to particular orders and must not be included among the ordinary oncost charges. This account may be designated Order Outlays and is kept in the General Ledger. In the Cost Ledger the amounts of such payments are debited to the accounts of the orders on behalf of which they are made and credited to an Order Outlays Account also in the Cost Ledger.

Additions to Plant.

We have only dealt with contracts and orders in hand in the consideration of the principles enunciated above, but we must still consider the provision made for costing the work undertaken as additions to the plant of the factory. These orders, during the course of their execution, fall to be treated in exactly the same way as orders for customers. Every order for new plant to be made in the factory receives a number and has an account opened for itself in the Cost Ledger. The only real difference of treatment is when the work is finished and the goods are transferred from the workshop or factory to their proper destination as additions to the factory plant. When such items occur frequently, the Day Book should be of a special pattern so as to secure the necessary entries in both the commercial and the costing systems of books with the minimum of labour. The following style of ruling is found suitable as the original record of the issue of finished goods to customers and as additions to the firm's own assets. Separate columns are provided for the posting folios of the commercial and costing systems, and without exception every Day Book entry should have against it the two references.

Item.	Posting Folios.		Sales.	Plant.
	Comml. Ledger.	Cost Ledger.		

All work completed, whether in the execution of a customer's order or as an addition to the plant of the business, is passed through this Day Book. In the commercial books, if the item is a sale or work for a customer, it is charged up to the customer; and if it be some part of plant manufactured within the factory for its own use, the Plant Account is charged therewith. Accordingly every item which appears in the Sales column of the Day Book is debited to a customer's account, and every item in the Plant column is debited to the Plant Account or some subdivision of it. The monthly total of the Sales column is credited to Sales Account, and at the time of balancing the books this Sales Account is closed into the Manufacturing Account. The monthly total of the Plant column can be treated in the same way through Additions to Plant Account, but the additions to plant are usually so few that it is quite practicable to credit the monthly total of the column direct to the Manufacturing Account. It is necessary also to show in the costing books the price charged for the additions to plant completed for the firm's own use. The separate items are credited from the Day Book to the respective cost accounts in the Cost Ledger, and the monthly total of the Plant column is debited to Additions to Plant Account also in the Cost Ledger.

Stock Orders.

The goods manufactured may be for stock, not for a booked order, and the treatment of these stock orders requires special explanation. When such orders are placed in the factory they follow the same routine as a booked order—a number is given to each, and an account opened for

each in the Cost Ledger. When the order is completed it cannot be passed through the Day Book as it is not a sale, it is merely a transfer to stock. A Stock Book is kept in which these transfers to stock are recorded. Every entry in that Stock Book is credited to its cost account at cost price, thereby closing the individual cost account for the article, and the totals of this Stock Book are periodically debited to a Stock Account, so that the effect of the postings from this Stock Book is to transfer the individual cost accounts for stock orders into one aggregate Stock Account. When stock is sold it is necessarily passed through the Day Book, and as our Day Book items must be posted to some Cost Ledger account as well as to the customer's account, the Day Book credit is to this Stock Account. This Stock Account thus bears at its debit the cost of manufacture of the goods made for stock, and at its credit the selling price realised for such of these goods as have been sold.

Day Book Postings.

To summarise the posting of this Day Book: in the commercial books the customers' accounts and Plant Account are debited with the individual items, and the totals of the respective columns are credited to Sales Account and Additions to Plant Account; and in the costing books the separate items are credited to the separate cost accounts of the orders to which the entries relate or to Stock Account, and the totals of the Sales and Plant columns are debited to Sales Account and Additions to Plant Account respectively. It will be observed that the postings of the commercial and costing systems are exactly the reverse of each other so far as the Day Book entries are concerned.

Closing the Cost Accounts.

The next part of the subject is the agreement of the commercial and the costing systems. Only one Cost Ledger has been spoken of, and it will be found sufficient in many cases to keep all the cost accounts within the compass of one Ledger, the cost accounts for the different orders or undertakings in the bulk of the Ledger, and the necessary general accounts towards the end on a different ruling. The individual cost accounts are squared when the work is finished by the Day Book item relating to it being posted to the credit of the account; if the Cr. side

be then the greater the balance is profit on the job, but if the Dr. be the greater it has resulted in a loss. These profits and losses should be transferred to the Manufacturing Account, thus squaring the separate cost accounts and gathering the results of the period's work into the general manufacturing account. The cost account of any order, which would appear in the tabular form already given as the Cost Ledger ruling, may be summarised thus:—

Order No. X. (Details of the Work or Nature of the Article Ordered).

Dr.	*Cr.*
To Stores per Stores Issued Book (entries would occur frequently for the material drawn from stores) less Credits for Stores returns.	By Stores Returned per Stores Returns Book (to be deducted from Stores item on Dr. side).
Wages per Wages Allocation Book (an entry of this nature would occur under every date for which wages were paid for this contract).	" A. B. per Day Book, Fol.
" Factory Oncosts being m% on Wages debited above.	
" General Establishment Charges being n% on Material and Wages debited above.	
" Balance on this account being net profit on contract.	

Every entry shown in the above summarised cost account has a corresponding debit or credit in the Cost Ledger, and in squaring the accounts we must be careful to preserve the balance. The Stores Account is closed by having the value of the stores on hand at the close of the period credited and carried down to the Dr. of the new account. The value of stores on hand, as brought out in the inventory, should be the amount required to square the stores account, but perfect agreement is seldom attained, and the difference which represents wastage is written off to the Manufacturing Account.

The following is a summary of the Stores Account in the Cost Ledger:—

Stores Account.

Dr.	*Cr.*
To Value of stores on hand at the beginning of the year. „ General Ledger Account for stores purchased per the Invoice Book (this entry would probably occur monthly). „ Returns per Stores Returns Book (this also might be a monthly entry).	By Stores issued on store warrant per Stores Issued Book (this entry would occur monthly). „ Wastage, to Manufacturing Account. „ Balance on this account, agreeing with the valuation of the stores on hand at this date, per Stock Sheets.

The Wages Account presently stands with the accumulated amount of the weekly or fortnightly wages bills at its credit. This account is merely kept for the sake of gathering these recurring items under one head, and it is closed at the time of balancing the books by debiting it with the sum required to square and crediting General Ledger Account with the same amount. The Factory Oncosts Account and the General Establishment Expenses Account are each credited with the total of the sums debited during the period to the various cost accounts in respect of the percentages of indirect productive charges and general profit and loss expenditure. These accounts are closed at the end of the financial year by debiting them with the sum required to square and crediting the amounts to the General Ledger Account. The Order Outlays Account is treated in the same way. It presently stands with a Cr. balance on it, and it should accordingly be closed by debiting it with the amount necessary to square and crediting such amount to the General Ledger Account.

The Sales Account shows the monthly totals of the Day Book at its debit; to square it a Cr. of the aggregate amount is made on this account and a corresponding Dr. entry made in the General Ledger Account. The Additions to Plant Account is treated in the same way—credit it with the amount required to close the account and debit General Ledger Account with the like sum. The Stock Account, to which are transferred finished goods as stock orders, has at its credit the prices realised for stock sales as posted from the Day Book, and at its

debit appear the amounts transferred from the individual cost accounts of the stock orders. On the Dr. side also appears the valuation of the stock of finished goods on hand at the beginning of the year, and the corresponding valuation as at the close of the year must now be credited at cost price and carried down. The balance on this account then represents profit or loss on stock sales, and is transferred to Manufacturing Account.

The Manufacturing Account is next in order to be closed off. In this account appear the profits and losses brought out on the different cost accounts of the individual contracts or orders, the profits earned on the jobs appear on the Cr. side, and the losses on the unremunerative work and also the wastage on stores on the Dr. side. To close the account the difference must be entered on the smaller side and transferred to the General Ledger account. This transfer takes the balance of profit or loss out of the Cost Ledger, and finally disposes of it. This balance of profit or loss should approximately agree with the net profit brought out on the Profit and Loss Account in the commercial books. The Manufacturing Account in summary then presents the following appearance:—

Manufacturing Account.

Dr.	*Cr.*
To Loss on contract No. 56 (and so on for the loss resulting from contracts finished during the year). Stores Account for shortage in stores on valuation. General Ledger Account for balance of profit.	By Profit on contract No. 69. „ Profit on Order No. 72 (and so on for the profit shown on all the cost accounts closed during the year).

The final account in the Cost Ledger, which is also the proof of the whole matter, is the General Ledger Account. This account sometimes bears the name Balance Account in this connection. It is the account in which appear in summary all the factors of cost and gross returns which are found debited and credited throughout the separate cost accounts in the Cost Ledger. In this way the Cost Ledger

Stores Account.

Dr.	*Cr.*
To Value of stores on hand at the beginning of the year. „ General Ledger Account for stores purchased per the Invoice Book (this entry would probably occur monthly). „ Returns per Stores Returns Book (this also might be a monthly entry).	By Stores issued on store warrant per Stores Issued Book (this entry would occur monthly). „ Wastage, to Manufacturing Account. „ Balance on this account, agreeing with the valuation of the stores on hand at this date, per Stock Sheets.

The Wages Account presently stands with the accumulated amount of the weekly or fortnightly wages bills at its credit. This account is merely kept for the sake of gathering these recurring items under one head, and it is closed at the time of balancing the books by debiting it with the sum required to square and crediting General Ledger Account with the same amount. The Factory Oncosts Account and the General Establishment Expenses Account are each credited with the total of the sums debited during the period to the various cost accounts in respect of the percentages of indirect productive charges and general profit and loss expenditure. These accounts are closed at the end of the financial year by debiting them with the sum required to square and crediting the amounts to the General Ledger Account. The Order Outlays Account is treated in the same way. It presently stands with a Cr. balance on it, and it should accordingly be closed by debiting it with the amount necessary to square and crediting such amount to the General Ledger Account.

The Sales Account shows the monthly totals of the Day Book at its debit; to square it a Cr. of the aggregate amount is made on this account and a corresponding Dr. entry made in the General Ledger Account. The Additions to Plant Account is treated in the same way—credit it with the amount required to close the account and debit General Ledger Account with the like sum. The Stock Account, to which are transferred finished goods as stock orders, has at its credit the prices realised for stock sales as posted from the Day Book, and at its

debit appear the amounts transferred from the individual cost accounts of the stock orders. On the Dr. side also appears the valuation of the stock of finished goods on hand at the beginning of the year, and the corresponding valuation as at the close of the year must now be credited at cost price and carried down. The balance on this account then represents profit or loss on stock sales, and is transferred to Manufacturing Account.

The Manufacturing Account is next in order to be closed off. In this account appear the profits and losses brought out on the different cost accounts of the individual contracts or orders, the profits earned on the jobs appear on the Cr. side, and the losses on the unremunerative work and also the wastage on stores on the Dr. side. To close the account the difference must be entered on the smaller side and transferred to the General Ledger account. This transfer takes the balance of profit or loss out of the Cost Ledger, and finally disposes of it. This balance of profit or loss should approximately agree with the net profit brought out on the Profit and Loss Account in the commercial books. The Manufacturing Account in summary then presents the following appearance:—

Manufacturing Account.

Dr.	*Cr.*
To Loss on contract No. 56 (and so on for the loss resulting from contracts finished during the year). Stores Account for shortage in stores on valuation. General Ledger Account for balance of profit.	By Profit on contract No. 69. „ Profit on Order No. 72 (and so on for the profit shown on all the cost accounts closed during the year).

The final account in the Cost Ledger, which is also the proof of the whole matter, is the General Ledger Account. This account sometimes bears the name Balance Account in this connection. It is the account in which appear in summary all the factors of cost and gross returns which are found debited and credited throughout the separate cost accounts in the Cost Ledger. In this way the Cost Ledger

is made self-balancing, and is therefore independent of the commercial books. The following is an illustration of how the General Ledger Account appears at the end of the financial year when the books have been closed:—

General Ledger Account.

Dr.	*Cr.*
To Sales Account. „ Additions to Plant. „ Balance carried down.	By Balance brought down. „ Stores Account for purchases during the year. „ Special Purchases Account for special purchases during the year. „ Wages Account for the productive wages expended during the year. „ Factory Oncosts Account for the percentage charged to Orders during the year. „ General Establishment Expenses Account for the percentage charged in respect thereof during the year. „ Order Outlays Account for petty cash payments chargeable to specific orders. „ Manufacturing Account for the balance of profit shown on the year's operations.

Assuming that all work was completed at the close of the year, all the accounts in the Cost Ledger are now closed for the year, and the only balances shown on the Ledger are the Dr. balance on the Stores Account for the stores on hand carried down to the new year, a Dr. balance on Stock Account for the closing valuation of the finished goods on hand, and a Cr. balance on the General Ledger Account shown above of the sum of these two debits. The Dr. and Cr. balances standing on the Ledger thus agree in amount, and the Ledger balances independently of any other books. Work in progress is dealt with by carrying down the balances (representing labour and material) on the cost accounts of the unfinished contracts, and the percentages of factory oncosts and general establishment charges on these contracts are provided for by

being calculated on the figures to date and credited to "Factory Oncosts Account" and "General Establishment Charges Account" respectively at the close of the year, and carried down to the debit of the new period's accounts.

Closing the Commercial Books.

Returning now to the commercial books, our first step is to pass through the Stores Account in the General Ledger the value of the stores on hand as brought out in the inventory, by crediting the old account and debiting the new as usual. The Stores Account is then closed for the old year by transferring the balance on it to the Manufacturing Account in the General Ledger. The amount so transferred represents the cost of the stores consumed in the year's manufacture. The Productive Wages account in the General Ledger is also closed into the Manufacturing Account, the amount transferred representing the cost of productive labour for the year. All the subsidiary accounts in the General Ledger for the heads of expenditure falling into factory oncost are then transferred in the first instance to a Factory Oncost Account, the obvious advantage of such a course being that the total factory oncosts are then shown in one figure, and the ratio which that total bears to the wages is at once ascertained and the working percentage of factory oncosts verified or adjusted. The Factory Oncosts Account is then closed into the Manufacturing Account; debit Manufacturing Account "To Factory Oncosts," and credit Factory Oncosts Account "By Manufacturing Account." The Sales Account and Additions to Plant Account are next closed by being debited with the amounts required to square, the Manufacturing Account being credited with the same amounts. The other accounts relating to extraordinary elements of cost, including the Special Purchases Account and the Order Outlays Account, should next be transferred to the Manufacturing Account. The cost to date of work in progress is included in the Stock Sheets along with the cost price of finished goods on hand, and the total of the Stock Sheets is passed through the Manufacturing Account to bring out the increase or decrease in stock as compared with the valuation as at the beginning of the year. The Manufacturing Account thus prepared appears in the following form:—

Manufacturing Account.

Dr.	*Cr.*
To Stores Account for material used during the year.	By Sales.
„ Productive Wages Account for cost of labour during the year.	„ Additions to Plant.
„ Factory Oncosts Account for direct expenses of production.	„ Increase of Stock: Stock on hand at end of year. *Less*—Stock on hand at beginning of year.
„ Special Purchases Account for extras purchased and applied to contracts.	
„ Order Outlays Account for petty - cash payments of expenses in connection with contracts.	
„ Balance, being gross profit, carried down.	

Although the foregoing Manufacturing Account is cast in the form usual in business, the gross profit thus brought out is not strictly true—the Stock Valuation includes the percentage for general establishment charges, which are Profit and Loss Account items, and accordingly any increase in Stock results in Manufacturing Account being credited with this percentage on such increase, and conversely with a decrease in Stock. The point is only important when gross profit is closely considered and when the Stock varies appreciably. The Profit and Loss Account is now written up in the usual way by transferring thereto all the balances on the nominal accounts and carrying to its credit the gross profit as brought out in the Manufacturing Account. The items which compose the general establishment charges all appear in the Profit and Loss Account, and the sum of these items is available for the verification or adjustment of the percentage laid on for general establishment charges. If the percentage of factory oncosts to wages and the percentage of general establishment expenses to material and wages, both of which percentages were arrived at on past years' experience, have been approximately true to the facts of the closing year, then the profit brought out on the Profit and Loss Account now being prepared in the General

Ledger will agree with the balance of profit brought out on the Manufacturing Account in the Cost Ledger. The agreement is never absolute on account of fractional differences and the inevitable fluctuations in the oncosts and general establishment expenses, but after making due allowances for these disturbing influences the profit shown by the two systems, the commercial and the costing, should be in substantial agreement. Another consideration to which weight must be given in reconciling the profit shown by the two systems is that if the business is increasing the percentage of standing charges will tend to decrease, while if the output is diminishing the expense-percentage will increase. After an irreducible minimum of expenses is provided for, the volume of business may increase to any extent, and that increase would require a diminishing percentage of outlay—in other words, the expense-burden does not vary proportionally with the volume of business, but tends to bear a reducing ratio to the output as the output increases, by spreading the fixed charges over the larger turnover.

The cost system suggested in the foregoing pages is merely sufficient to embody the main principles which any cost records must conform to, but the particular circumstances of the case in view must prescribe the essential features to be possessed by the system being framed for its use. The first elaboration of these principles will usually be in the direction of keeping more than one Cost Ledger. If the cost accounts are divided up into two sections or groups, the obvious division would be to separate the cost accounts of the various orders from the general accounts of Stores, Wages, Oncosts, etc. The next step would be to separate the stores into classes according to the nature of the goods; that is, the Stores Account would be kept in a number of divisions instead of in one general Stores Account as indicated in the foregoing outlines. As already pointed out, it is desirable in these stores accounts, where the nature of the material lends itself to the proceeding, to record not only the money values of the stores but the quantities received and issued. The value of the stores on hand of each kind would be carried down on the different stores accounts, and a general Stores Account should be kept into which the balance of these subsidiary accounts should be carried at the close of the year,

the advantage of bringing together the amount of the stores of all kinds used being of course to show in one total the cost of material used for the period in the manufacture. In the commercial General Ledger there would still only be one Stores Account kept with the balance on which the aggregate balances of the subsidiary stores accounts in the Cost Ledger should agree, allowing for wastage. Further subdivision of any of the accounts referred to in the system outlined is thus simply a matter of opening separate accounts in the cost ledgers for the subdivisions necessary, and at the close of the books these subdivisions of some main head of expenditure may be carried into a general account to bring out the total of that head if that be required as the basis of future work, or, if not, the subdivisions can be carried directly into the adjustment account for the final reconciliation. If the stock of finished goods carried be heavy, it might be of advantage to keep a Stock Ledger in which there would be separate accounts for the various classes of stock. The Stock Account outlined would still be kept, and its balance at any time would equal the aggregated balances on the accounts in the Stock Ledger.

When a factory is divided into separate departments or shops the expenses special to each department or shop must be kept separate, and there must also be kept an account for the expenditure general to all the departments. The general factory oncosts are in such a case first allocated among the separate shop oncost accounts, and thereafter the shop oncosts are apportioned over the contracts wholly or partly executed in the several shops.

VI.—PARTNERSHIP

THE statutory definition of Partnership as given in the Partnership Act, 1890, is "the relation which subsists between persons carrying on a business in common with a view of profit." In other words, a partnership is a combination of persons to carry on a business with gain as their object. These persons are spoken of as "the partners," and the partners collectively are "the firm."

It is essential to an understanding of partnership affairs to recognise that the firm has an identity apart from the persons composing it; thus, in the firm of A & B there are A the individual, B the individual, and A & B the firm—three parties, each with interests distinct from and perhaps antagonistic to the others.

Contract of Copartnery.

The stipulations as to the terms on which the partners are associated are contained in a contract or agreement between them which is termed the "Articles of Copartnership" or Deed or "Contract of Copartnery." Among other provisions in this deed are the name and business of the firm, the capital of the firm and the proportions thereof to be held by the several partners, the manner in which the profits or losses are to be divided among the partners, and the provisions for the dissolution of the firm and winding up of its affairs. In so far as not provided for by the Contract of Copartnery, the relations between the partners are regulated by the Partnership Act, 1890, in sec. 24 of which it is provided *inter alia* that, subject to special agreement between the partners, (1) they shall share profits and losses equally; (2) any partner advancing extra capital to the firm shall receive interest thereon at 5 per cent. per annum; (3) partners are not entitled to interest on their capital; and (4) partners are not entitled to any remuneration for acting in the firm's business.

The radical differences in partnership accounts arise wholly from the plurality of partners; separate accounts must be kept for the several partners to record their interest in the concern. The first distinctive feature in partnership accounts, therefore, is a separate Capital Account for each of the partners. These Capital Accounts are kept on the same principle as before—debit a partner's Capital Account with all that he receives, and credit it with all that he gives. When a firm starts business by the partners putting in cash, the entries are Cash Dr. for the sums received, A's Capital Account Cr. for what he gives, and B's Capital Account Cr. for the sum he gives. When the business has been carried on previously and it is desired to open a new set of books, a Balance Sheet as at the opening date must be prepared showing the assets and liabilities, and the capital must be shown in the proportions held by the partners, thus:—

Partners' Capital Accounts.

Opening Entries.

Balance Sheet as at 31st December . . .

Liabilities.			*Assets.*	
Creditors' Accounts		£291 7 6	Customers' Accounts .	£795 8 4
Capital—			Stock on hand . .	424 9 3
A	£754 12 9		Plant and Fittings .	116 11 8
B	390 8 7		Cash at Bank . .	95 6 4
		1145 1 4	Cash on hand . .	4 13 3
		£1436 8 10		£1436 8 10

To open a set of books from the information in the foregoing Balance Sheet the items should first be journalised, thus:—

		Dr.	
Jan. 1.	Sundries, viz.:		
	Customers' Accounts, per List . .	£795 8 4	
	Goods	424 9 3	
	Plant and Fittings	116 11 8	
	Bank	95 6 4	
	Cash	4 13 3	
	To Sundries, viz.:		
	Creditors' Accounts, per List		£291 7 6
	A's Capital Account . .		754 12 9
	B's Capital Account . .		390 8 7
	being Assets and Liabilities at this date		
		£1436 8 10	£1436 8 10

These Journal entries are posted to the Ledger (Cash and Bank balances to their respective columns in the Cash Book), the debits "To Balance" and the credits "By Balance," and as the two sides of the Balance Sheet agree in their sum, the debits and credits thus posted must also agree. The books are then on the balance and ready for the entry of the transactions. In every respect, apart from items affecting the partners' accounts, the accounts of a firm are kept in the same way as those of an individual, dealt with in the preceding chapters.

From time to time during the financial year the partners draw cash or goods from the business for their own use, or they may put in cash for which they have no other investment available. Each partner's Capital Account must be debited with his withdrawals and credited with the cash put in by him during the year.

Partners' Drawings.

When the firm's Profit and Loss Account has been written up the net profit for division between the partners is arrived at, but before this can be allocated and transferred to the Capital Accounts we must consider the provisions of the Contract of Copartnery. This brings us to the discussion of the methods of division frequently met with in such contracts. The allocation of the profit brought out on the Profit and Loss Account may be considered in three sections, viz. (1) Interest on Capital; (2) Salaries to Partners; (3) Balance of Net Profit.

If the firm's capital be held equally by the partners and the profits are shared equally between them, there is no inequity, but in actual business such a condition of things seldom exists. The partners' accounts are periodically credited with the ascertained profits and debited with their withdrawals of cash and goods, and as a result their capital either exceeds or falls short of the amount or proportion stipulated for in the Contract of Copartnery. Further, it is in most cases an advantage to a firm to have at its disposal ready money with which to meet its creditors' accounts promptly and thereby earn good cash discounts. Accordingly, it is expedient that the partners should have some inducement to leave surplus capital at their credit

Interest on Capital.

in the firm, as otherwise their own interests would be best served by investing it elsewhere for their own benefit. To meet such cases and to avoid any inequity which might arise thereout, it is usual for the Contract of Copartnery to provide that there shall be charged against the firm's profits interest on the whole or only on the surplus capital at the partners' credit. It is necessary that the distinction between the firm's and the partners' advantage should be clearly apprehended. For the allowance of such interest to a partner out of his firm's profits we have the entry, Profit and Loss Dr. to the partner's Capital Account; that is, the firm, through its Profit and Loss Account, is being charged with the interest, and the individual partner is being credited with the interest earned by his capital and for which he has become creditor of the firm. The usual case is to allow the partners "interest on the Capital at their credit from time to time." This interest-earning capital is the amount credited in their Capital Accounts minus their withdrawals. The most expeditious method of ascertaining the amount of such interest is shown on the opposite page.

The first step is to find the number of days between the dates of the transactions and the close of the account. In the example given it will be seen that the days for which interest is charged and allowed are those for which the cash was at the disposal of the firm (for the credits) and for which the firm was deprived of it by its withdrawal (for the debits). The numbers of days elapsing between the various transactions are interlined, as shown on B's Capital Account, Dr. side, and these days are then summed progressively, beginning at the closing date, to find the days for which interest has run. The interest tables are then used to find the amount of interest; then the entry for the net interest is made on the Dr. or Cr. side of the account, as the case may be, and if the partners' Capital Accounts are credited, obviously the firm's Profit and Loss Account is to be debited. What the individual partner has earned on his investment with the firm, the firm must reckon as loss or expenditure. The rate of interest is of course given in the Contract of Copartnership, and is commonly 4 or

A's Capital Account.

Dr.

Date	Particulars	Days.	Interest.	Amount
Aug. 3.	To Cash . . .	150	£0 10 3¼	£25 0 0
Dec. 31.	„ Goods for half-year . .	0	...	3 11 3
				£ 28 11 3
	„ Balance			708 17 11
				£737 9 2

Cr.

Date	Particulars	Days.	Interest.	Amount
June 30.	By Balance . .	184	£16 7 8	£650 0 0
Dec. 31.	„ Interest :			
	Cr. . . .		£16 7 8	
	Dr. . . .		0 10 3¼	
				15 17 5
	„ One-half Net Profit			71 11 9
				£737 9 2
Dec. 31.	By Balance			£708 17 11

B's Capital Account.

Dr.

Date	Particulars	184 Days.	Interest.	Amount
		10		
July 10.	To Cash . . .	174	£0 14 3½	£30 0 0
		36		
Aug. 15.	„ „	138	0 7 6¾	20 0 0
		58		
Oct. 12.	„ „	80	0 5 5¾	25 0 0
		30		
Nov. 11.	„ „	50	0 2 0¾	15 0 0
		50		
Dec. 31.	„ Goods for half-year	0	...	2 15 5
			£1 9 4¾	£92 15 5
	„ Balance			436 3 5
				£528 18 10

Cr.

Date	Particulars	Days.	Interest.	Amount
June 30.	By Balance . .	184	£8 16 5½	£350 0 0
Dec. 31.	„ Salary for half-year			100 0 0
	„ Interest :			
	Cr. . . .		£8 16 5½	
	Dr. . . .		1 9 4¾	
				7 7 1
	„ One-half Net Profit			71 11 9
				£528 18 10
Dec. 31.	By Balance			£436 3 5

5 per cent. per annum. The profit allocated in the foregoing example was £266 8 0

against which there is chargeable under the Contract interest at 5 per cent. on the partners' Capital amounting to . . . A .	£15	17	5				
B .	7	7	1				
	£23	4	6				
and a Salary to B at £200 per annum	100	0	0				
					123	4	6
leaving as the balance of Net Profit which is to be shared equally by the Partners— . . .					£143	3	6
A .	£71	11	9				
B .	71	11	9				
					£143	3	6

The effect, then, of charging a firm's Profit and Loss Account with interest on the partners' Capital is to remunerate the partners for their investment in the business, and thereby to equalise differences arising from the varying proportions of the capital actually held by the partners.

Salaries to Partners.

In the same way as interest on Capital is provided for to adjust the claims of partners in respect of varying amounts of capital placed at the firm's disposal, so is it often necessary to make provision for remunerating individual partners for special abilities or more active participation in the firm's business than their copartners may give. It not infrequently happens that one partner of a firm is prepared to employ his whole time and exercise all his abilities in furthering the firm's interests, while his copartners may take very little active concern with the firm's affairs. This consideration is strengthened when we deal with a firm with what is called a "sleeping partner," that is, one who is associated with the firm more as an investor in it and taking no active part in the conduct of the business. Obviously, in such cases before dividing the net profit it is only equitable to charge thereon an agreed-on sum in name of salary to the partner or partners who have devoted their whole time and

abilities to the firm's affairs. Any such allowance must be clearly stipulated for in the Contract of Copartnership. The entry for such a charge is, debit the Profit and Loss Account and credit the Capital Account of the partner entitled to the allowance, that is, the firm is being charged through its Profit and Loss Account, and the individual partner earning the salary is credited in his Capital Account. Salaries to partners should not be classed among the staff salaries in Salaries Account; they are not business expenses like the staff salaries, but must be regarded rather as a part of the net profit specially allocated. Partners entitled to salaries do not usually draw them in regular instalments, therefore, wherever provision is made for them in the Contract of Copartnership, the simplest method of treatment is to debit the partners and credit Cash with *all* the cash they draw from the business, whether in name of salary or not, and credit them and debit Profit and Loss Account with the salaries they are entitled to under the Contract; in this way no confusion can arise from irregularly-drawn salaries.

Allocation of Profit.

The Profit and Loss Account of a firm A & B whose partners are entitled to interest on Capital, and also to salaries, in the allocation of the Net Profit, would appear as follows:—

Dr. *Profit and Loss Account.* *Cr.*

Dec. 31.	To Rent and Rates				£126	10	0	Dec. 31.	By Gross Profit from Goods Account	£1000	0	0
	„ Wages and Salaries				473	12	6		„ Discounts from Wholesale Houses . .	98	17	6
	„ General Charges .				210	4	0		„ Dividends from Investments .	43	4	5
	„ Carriages . .				15	4	9					
	„ Bad Debts and Discounts . .				50	2	8					
					£875	13	11					
	„ Interest on Capital:											
	A	£15	17	5								
	B	7	7	1								
					23	4	6					
	„ Salary to B at £200 per annum				100	0	0					
	„ Net Profit allocated:											
	A	£71	11	9								
	B	71	11	9								
					143	3	6					
					£1142	1	11			£1142	1	11

The foregoing illustration shows that in respect of Interest on Capital the firm (A & B) has been debited, and the individual partners A and B have been credited with their respective amounts. With regard to the salary to B at £200 per annum, A & B has been debited therewith in the Profit and Loss Account, and B—the individual partner entitled to the salary—has been credited in his Capital Account. Here we have the firm of A & B being charged with items which are gains to the individual partners—Debit the firm and credit the partners. These provisions as to interests and salaries do not affect the amount of the profit; they only affect the shares of profit falling to the individual partners. They are but rules for the allocation of the profit earned, having regard to the special circumstances of the firm.

Apart from special provisions contained in the Contract of Copartnership, the profits of a partnership are divisible equally among the partners. Where, however, a Contract is in existence it never fails to lay down the terms of allocation of the profit. If such Contract provide for the firm being charged with interest on Capital and Salaries to all or any of the partners, effect would be given to these provisions in the manner indicated under the last two heads. Any net profit remaining after these appropriations would be transferred from Profit and Loss Account to the credit of the partners' Capital Accounts in the agreed-on proportions. It will be observed in the last illustration that the partners' names are given in the Profit and Loss Account as subheads. This is desirable because then the Dr. of that account contains the exact items which appear at the Cr. of the partners' accounts, and the account thus gives, at first sight, all the information that could be required in connection with the adjustments.

Partners' Current Accounts.

In the introductory remarks to this chapter it was stated that among the other matters settled by the Contract of Copartnery is the amount of the Capital of the firm and the proportion or amount thereof to be held by the several partners. Yet it would be difficult to reconcile the Capital standing at the partners' credit in many firm's books from time to time with the sums specified in the Contract; the reason for the differences is the common, almost

invariable, practice of carrying to the debit and credit of the partners' Capital Accounts the drawings, interest on capital, partners' salaries, and shares of profit, thus making the Capital Accounts' balances fluctuating amounts instead of the fixed sums provided under the Contract. To overcome the disadvantage arising from utilising the Capital Accounts as general accounts of the partners, it is necessary to keep two accounts for each partner—first, the Capital Account proper, and second, a Current Account. The former carries permanently at its credit the amount stipulated by the Contract, the latter is credited with the interest, salary, share of profit, and any sums lent by the partner, and is debited with drawings and share of loss, if any. Such a method of separating the capital from the general transactions on the partners' accounts is specially to be commended where the Contract provides for no interest being allowed on capital but only on additional sums standing at the partners' credit. These last-mentioned sums are referred to in secs. 24 and 44 of the Partnership Act, 1890, as "advances," and in some Contracts as "loans." The accounts of A and B, before shown in the common form, are given hereunder illustrating this method of treatment. It is supposed for this illustration that the firm's Capital consists of £900, of which under the Contract two-thirds is held by A and one-third by B, that capital carries no interest, but that other sums standing at the partners' credit are to carry 5 per cent. per annum.

A's Capital Account.

Dr.		Cr.		
		Jan. 1.	By Sundries, being two-thirds of firm's capital under Art. 3 of Contract .	£600

A's Current Account.

Dr.		Days.	Interest.		Cr.		Days.	Interest.	
Aug. 3.	To Cash	150	£0 10 3¼	£25 0 0	Jun. 30.	By Balance	184	£1 5 3	£50 0 0
Dec. 31.	„ Goods	0		3 11 3	Dec. 31.	„ Interest:—			
				£28 11 3		Cr.		1 5 3	
						Dr.		0 10 3¼	
									0 15 0
	„ Balance			105 2 4		„ One-half Net Profit			82 18 7
				£133 13 7					£133 13 7
					Dec. 31.	By Balance			£105 2 4

B's Capital Account.

Dr.	*Cr.*
	Jan. 1. By Sundries, being one-third of firm's capital under Art. 3 of Contract . £300

B's Current Account.

Dr.

Date	Particulars	184 Days.	Interest.					
July 10.	To Cash	10 174	£0	14	3¼	£30	0	0
Aug. 15.	„ „	36 138	0	7	6¾	20	0	0
Oct. 12.	„ „	58 80	0	5	5¾	25	0	0
Nov. 11.	„ „	30 50	0	2	0¾	15	0	0
Dec. 31.	„ Goods	50 0				2	15	5
			£1	9	4½	£92	15	5
	„ Interest:— Dr.		£1	9	4½			
	Cr.		1	5	3			
						0	4	2
	„ Balance . . .					139	19	0
						£232	18	7

Cr.

Date	Particulars	Days.	Interest.					
June 30.	By Balance	184	£1	5	3	£50	0	0
Dec. 31.	„ Salary for half-year . . .					100	0	0
	„ One-half of Net Profit . .					82	18	7
						£232	18	7
Dec. 31.	By Balance . . .					£139	19	0

The aggregate sum at the credit of these accounts is the same as by the former method, but the partners' holdings are different on account of the capital not carrying interest this time and the fact that while the capital is held in the proportion of two-thirds and one-third the balance of profit is divisible equally. The net result is therefore that interest on £900 of Capital formerly earned two-thirds by A and one-third by B now falls into the balance of divisible profit which is shared equally.

The Assumption of a Partner.

We have now discussed the treatment of the items peculiar to the accounts of a partnership during its subsistence, and it now remains to consider the book-keeping aspect of changes in the constitution of the firm. Let us

take an illustration. A has carried on a business for some years for his own behoof, and he has now agreed to assume B as his copartner on the terms set forth in the Contract of Copartnery arranged between them. It would be obviously unfair to A were B to acquire an interest in the business without payment for the privilege, now that it has been well established, and thus to avoid all the risk of loss inseparable from the starting of a new business. To obviate such an injustice it is usual for the incoming partner to be charged for the established connection, the settled custom. This is termed the "Goodwill." The student of book-keeping need not enter upon an exhaustive study of Goodwill, but it is necessary to an intelligent appreciation of the problems connected therewith that he have an understanding of its principal features. Goodwill has been defined as "nothing more than the probability that the old customers will resort to the old place" (Lord Eldon, 1810), and as "every advantage that has been acquired by the old firm by carrying on the business, everything connected with the premises and the name of the firm" (Vice-Chancellor Wood, 1859), and again as "the benefit of the good name, reputation, and connection of a business; it is the attractive force which brings in custom" (Lord Macnaghten, 1901).

Goodwill.

Goodwill is commonly valued at so many years' purchase of the average net profit, the nature of the business deciding what is a fair price. Thus, a business may depend solely on its situation for its custom, another on the personality of a partner, and another on the reputation of its goods. In any purchase of goodwill the benefit of the controlling element in bringing in the custom must be secured to the new firm, so as to render probable a continuance of the old custom. In the case supposed in our illustration the transaction can be completed in one of two ways. (1) B may pay over to A in cash the price of the share of the goodwill he is acquiring; thus, if the goodwill is valued at £800 and B is acquiring a half share in the firm, B must pay to A £400. This might be done without the transaction appearing in the books at all, but the more usual case is for B to put in say £1400 of cash, being his Capital of £1000 and the price of his half of the goodwill £400.

B's Capital Account.

Dr.	*Cr.*
	Jan. 1. By Sundries, being one-third of firm's capital under Art. 3 of Contract . £300

B's Current Account.

Dr.		184 Days.	Interest.					*Cr.*		Days.	Interest.			
July 10.	To Cash	10 174	£0 14 3½	£30	0	0		June 30.	By Balance	184	£1 5 3	£50	0	0
Aug. 15.	" "	36 138	0 7 6¾	20	0	0		Dec. 31.	" Salary for half-year . . .			100	0	0
Oct. 12.	" "	58 80	0 5 5¾	25	0	0			" One-half of Net Profit . .			82	18	7
Nov. 11.	" "	30 50	0 2 0¾	15	0	0								
Dec. 31.	" Goods	50 0		2	15	5								
			£1 9 4¾	£92	15	5								
	" Interest:— Dr. Cr.		 £1 9 4¾ 1 5 3	0	4	2								
	" Balance . . .			139	19	0								
				£232	18	7						£232	18	7
								Dec. 31.	By Balance . . .			£139	19	0

The aggregate sum at the credit of these accounts is the same as by the former method, but the partners' holdings are different on account of the capital not carrying interest this time and the fact that while the capital is held in the proportion of two-thirds and one-third the balance of profit is divisible equally. The net result is therefore that interest on £900 of Capital formerly earned two-thirds by A and one-third by B now falls into the balance of divisible profit which is shared equally.

The Assumption of a Partner.

We have now discussed the treatment of the items peculiar to the accounts of a partnership during its subsistence, and it now remains to consider the book-keeping aspect of changes in the constitution of the firm. Let us

take an illustration. A has carried on a business for some years for his own behoof, and he has now agreed to assume B as his copartner on the terms set forth in the Contract of Copartnery arranged between them. It would be obviously unfair to A were B to acquire an interest in the business without payment for the privilege, now that it has been well established, and thus to avoid all the risk of loss inseparable from the starting of a new business. To obviate such an injustice it is usual for the incoming partner to be charged for the established connection, the settled custom. This is termed the "Goodwill." The student of book-keeping need not enter upon an exhaustive study of Goodwill, but it is necessary to an intelligent appreciation of the problems connected therewith that he have an understanding of its principal features. Goodwill has been defined as "nothing more than the probability that the old customers will resort to the old place" (Lord Eldon, 1810), and as "every advantage that has been acquired by the old firm by carrying on the business, everything connected with the premises and the name of the firm" (Vice-Chancellor Wood, 1859), and again as "the benefit of the good name, reputation, and connection of a business; it is the attractive force which brings in custom" (Lord Macnaghten, 1901).

Goodwill.

Goodwill is commonly valued at so many years' purchase of the average net profit, the nature of the business deciding what is a fair price. Thus, a business may depend solely on its situation for its custom, another on the personality of a partner, and another on the reputation of its goods. In any purchase of goodwill the benefit of the controlling element in bringing in the custom must be secured to the new firm, so as to render probable a continuance of the old custom. In the case supposed in our illustration the transaction can be completed in one of two ways. (1) B may pay over to A in cash the price of the share of the goodwill he is acquiring; thus, if the goodwill is valued at £800 and B is acquiring a half share in the firm, B must pay to A £400. This might be done without the transaction appearing in the books at all, but the more usual case is for B to put in say £1400 of cash, being his Capital of £1000 and the price of his half of the goodwill £400.

Here we have Cash Dr. and B's Capital Account Cr. for the £1400, and then a cross entry must be made debiting B's Capital Account and crediting A's Capital Account with the £400, for which B is A's debtor in respect of the half goodwill being acquired by B from A. Of course the cash entry of £1400 could be posted—£1000 to the credit of B's Capital Account for his capital put in, and £400 to the credit of A's Capital Account as the accretion to his capital in respect of the cash value of the half goodwill he is now realising. This method is undesirable, as giving too great publicity in the books to an item of a private nature. Or (2) the entries may be made in the books crediting A (the original owner of the concern) with the whole value of goodwill as agreed on (£800) and debiting this sum to a Goodwill Account. Goodwill is a kind of property although intangible in its nature, and when any change in the constitution of a firm takes place it is best to consider the old firm as disposing of the business to its newly-formed successor. Therefore, when A assumes B as a partner we have A selling the business to A & B, and A is to receive £800 as consideration for the goodwill. As A is to remain in the new firm his Capital Account is credited with the goodwill as a form of capital he gives to the new firm, and as such goodwill becomes the property of the new firm a Goodwill Account must be opened and the price debited thereto.

Take another illustration of a more complex nature. A and B are the two partners of the firm of A & B, and they agree to assume C as a partner and change the firm name to A, B, & C. A and B have equal interests in the old firm—that is half profits each—and all three partners of the new firm are to be equally interested in the profits of the new firm, that is one-third each. The price of the one-third goodwill being acquired by C has been fixed at £1000, and this is best regarded as compensation payable to A and B for the reduction of their shares of profits from one-half to one-third each. C thus owes £500 to A and a similar sum to B, and he may pay these sums over directly to them and then invest his Capital, say of £4000, in his new firm. The fact of his partnership would be sufficient to secure him his share of the goodwill if it were to be realised on a dissolution. The goodwill, in fact, if settled for in this way, would be an unbooked asset. The alternative method of settlement is as follows:—The goodwill is valued at £3000, seeing that one-third share is to cost £1000. This £3000 belongs in equal portions to A and B, the partners of the vendor firm, therefore credit the Capital Accounts of A and B with half each, *i.e.* £1500, and debit Goodwill Account with £3000, the value of the asset in goodwill. C. would then introduce as his Capital his whole £5000, and would be credited therewith as his share in the partnership assets, which now include the formerly excluded item of goodwill.

When a new partner is assumed the original partners of the firm not unfrequently guarantee certain of the floating assets acquired by the new firm. For example, the book debts may be taken over at their book value without any deduction by way of bad debt reserve, on condition that the original partner or partners guarantee them. In such circumstances the agreement simply means that if any of these assets realise less than their book values, the shrinkage, instead of being charged against the new firm's Profit and Loss Account, would be charged against the original partners. Failing such a provision between the incoming and the original partners, and if other circumstances are not inconsistent with such a construction, it must be assumed that the new firm took over the whole assets at their book values, and accordingly that any shrinkage in these values on realisation must be borne by the new firm.

The Retiral of a Partner.

When a firm is dissolved by the death or retiral of a partner the questions presenting themselves for solution are similar to those arising on the assumption of a partner, and goodwill again forms the principal consideration. In this case also it is simplest to regard the new firm as taking over the business from the dissolving firm, and any goodwill being paid for should be treated in the new firm's books as an asset. For example, the firm of A, B, & C is being dissolved by the retiral of A. The Contract of Copartnery lays down the rules for the valuation of the whole

Goodwill.

goodwill of the business in such a contingency, and the amount of such valuation has already been ascertained to be £1200, in which the three parties are equally interested. It is required to adjust the accounts of the partners so as to show the sum due to A, the retiring partner. There are two ways in which this can be done:—(1) The purchase price of the goodwill to the new firm of B & C is £1200, therefore in their books the entries are, Goodwill Account Dr. £1200, and A's Account, B's Capital Account, and C's Capital Account each Cr. for £400. The firm of B & C would thus show upon its books an asset in goodwill of £1200, and A would be paid his one-third share of its value in the ordinary course of paying out the sum standing at his credit with the firm. Or (2) consider only the price *paid* for goodwill, in which case the above transaction would be passed through thus, Goodwill Account Dr. and A's Account Cr. for £400. The Goodwill Account would thus show only the cash cost of the goodwill, and the new firm's book asset in respect of such goodwill would of course only stand at the £400 paid to A. The former method shows the facts of the transaction, the second method gives credit to the retiring partner for the value of his share of the goodwill, while his continuing copartners holding equal shares with him do not take credit in their accounts for their share of the asset they are transferring to their new firm. The underlying motive for the adoption of the second method is to keep down goodwill at its minimum on account of its problematical value.

Apportioned Profits.

In businesses in which stock-taking is a laborious process it is often provided in the Contract of Copartnery that in the event of the death of a partner the deceased partner's share of profits for the year then current is to be ascertained on the basis of the preceding year's profits or the average of the three years immediately preceding. This is to obviate the necessity of a stock-taking and a balance of the books for the ascertainment of the deceased partner's interest in the firm as at his death. Under such circumstances when the books are balanced next following such an event the allocation of the profit must be made by first appropriating the interest, proportion of salary, and proportion of profits falling to the deceased partner's

representatives as provided by the Contract, and thereafter allocating the balance of profit or the loss among the existing partners according to their interests.

Future Interest.

If interest is to be paid on the instalments of the sum due to the deceased partner's representatives and bills are granted for these instalments including interest, care must be taken in any Balance Sheet prepared during the currency of those bills to deduct from the firm's liability under them the proportion of such interest effeiring to a future period.

Settling of Accounts on a Dissolution of the Firm.

Rules for Distribution.

As has been already stated, the provisions of the Partnership Act, 1890, govern the relations of the partners in so far as their contract does not specially regulate all the conditions met with during the subsistence of the partnership or in the course of its winding-up. Section 44 is as follows:—"*Rule for distribution of assets on final settlement of accounts.* In settling accounts between the partners after a dissolution of partnership the following rules shall, subject to any agreement, be observed:—

"(*a*) Losses, including losses and deficiencies of capital, shall be paid first out of profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits:"

[*Note.*—"When Act says losses are to be borne equally (s. 24 (1)) it means losses sustained by the firm." *Per* Joyce, J., in *Garner* v. *Murray.*]

"(*b*) The assets of the firm, including the sums, if any, contributed by the partners to make up losses or deficiencies of capital, shall be applied in the following manner and order:—

"1. In paying the debts and liabilities of the firm to persons who were not partners therein;

"2. In paying to each partner rateably what is due

from the firm to him for advances as distinguished from capital;

"3. In paying to each partner rateably what is due from the firm to him in respect of capital;

"4. The ultimate residue, if any, shall be divided among the partners in the proportion in which profits are divisible."

[*Note.*—"Subsection (*b*) proceeds on the supposition that contributions have been paid or levied." *Per* Joyce, J., in *Garner* v. *Murray*.]

Realisation Account.

When the firm's assets are being realised it is necessary to show the result of the realisation in a special account to ascertain the accretion or shrinkage, so that such may be credited or debited to the partners' accounts, (1) in the proportions set out in the contract; or (2) failing such provisions for a dissolution, then in the proportions in which the partners shared trade profits or losses under their contract; or (3) failing that, then equally in terms of sec. 24, subsec. (1), of the Act.

First Case.

Assume a simple case of three partners, A, B, and C, whose firm Balance Sheet just before entering upon the winding-up stood thus:—

BALANCE SHEET of the Firm of A, B, & C just prior to Winding-up.

Liabilities.			*Assets.*	
Trade Creditors . .		£700 0 0	Book Debts . . .	£1500 0 0
Bank Overdraft . .		600 0 0	Stock in trade . .	1000 0 0
Advances from Partners—			Plant, Fittings, and Furnishings . . .	375 0 0
A .	£500 0 0		Cash on hand . .	25 0 0
B .	400 0 0			
		900 0 0		
Capital—				
A .	£350 0 0			
B .	250 0 0			
C .	100 0 0			
		700 0 0		
		£2900 0 0		£2900 0 0

The business of the firm is sold as a going concern, the Book Debts being taken over at book value less 5 per cent., the Stock in trade as valued in the Stock Sheets, and the Plant, Fittings, and Furnishings at a valuation which amounts to £350. It is required to adjust the partners' accounts—the partners' share profits and losses in the proportion of two-fifths each to A and B and one-fifth to C.

DISSOLUTION ACCOUNTS of the Firm of A, B, & C.

I. *Realisation Account.*

Dr.		*Cr.*		
To Book Value of Assets at the commencement of the winding-up—		By X & Y for Sundry Assets acquired by them—		
Book Debts per Schedule .	£1500 0 0	Book Debts £1500, less 5 per cent. .		£1425 0 0
Stock in trade per Stock Sheets . .	1000 0 0	Stock as valued in Stock Sheets . .		1000 0 0
Plant, Fittings, and Furnishings . .	375 0 0	Plant, Fittings, and Furnishings per Valuation by Z .		350 0 0
	£2875 0 0			£2775 0 0
To Firm's share of expenses of transfer .	40 0 0	By Partners' Accounts for Loss on realisation—		
		A, $\frac{2}{5}$ths	£56 0 0	
		B, $\frac{2}{5}$ths	56 0 0	
		C, $\frac{1}{5}$th	28 0 0	
				140 0 0
	£2915 0 0			£2915 0 0

II. *Partners' Capital Accounts.*

1. *A's Capital Account.*

Dr.		*Cr.*	
To Realisation Account for $\frac{2}{5}$ths Loss . .	£56 0 0	By Balance brought forward . .	£350 0 0
" Cash . . .	294 0 0		
	£350 0 0		£350 0 0

2. B's Capital Account.

Dr.		*Cr.*	
To Realisation Account for ⅖ths Loss . .	£56 0 0	By Balance brought forward . .	£250 0 0
„ Cash . . .	194 0 0		
	£250 0 0		£250 0 0

3. C's Capital Account.

Dr.		*Cr.*	
To Realisation Account for ⅕th Loss . .	£28 0 0	By Balance brought forward . .	£100 0 0
„ Cash . . .	72 0 0		
	£100 0 0		£100 0 0

III. *Cash Account.*

Dr.		*Cr.*	
To Balance brought forward . .	£25 0 0	By Paid Firm's share of expenses of transfer . .	£40 0 0
„ X & Y for Price of Assets taken over by them .	2775 0 0	„ Trade Creditors' Accounts paid per Schedule .	700 0 0
		„ Paid into Bank Amount of Overdraft .	600 0 0
		„ Repaid A on Advance Account	500 0 0
		„ Repaid B on Advance Account	400 0 0
		„ Paid A on Capital Account .	294 0 0
		„ Paid B on Capital Account . .	194 0 0
		„ Paid C on Capital Account . .	72 0 0
	£2800 0 0		£2800 0 0

Second Case. Let us assume, however, a worse position in the winding-up, a position necessitating a contribution by partners and one partner unable to make such a contribution. The assets of A, B, and C are sold for a lump sum of £2000, otherwise matters are as in the previous case:—

I. *Realisation Account.*

Dr.		*Cr.*	
To Book Value of Assets (*all as before*) .	£2875 0 0	By X & Y, Price of Assets as agreed . .	£2000 0 0
„ Firm's share of expenses of transfer .	40 0 0	„ Loss on Realisation— A, ⅖ths £366 0 0; B, ⅖ths 366 0 0; C, ⅕th 183 0 0	915 0 0
	£2915 0 0		£2915 0 0

II. *Partners' Accounts.*

1. *A's Capital Account.*

Dr.		*Cr.*	
To ⅖ths Loss on Realisation . .	£366 0 0	By Balance brought forward . .	£350 0 0

2. *B's Capital Account.*

Dr.		*Cr.*	
To ⅖ths Loss on Realisation . .	£366 0 0	By Balance brought forward . .	£250 0 0

3. *C's Capital Account.*

Dr.		*Cr.*	
To ⅕th Loss on Realisation . .	£183 0 0	By Balance brought forward . .	£100 0 0

III. *Cash Account.*

To Balance brought forward . .	£25 0 0	By Paid Firm's share of expenses of transfer . .	£40 0 0
„ X & Y, Price of Assets . .	2000 0 0	„ Trade Creditors' Accounts .	700 0 0
		„ Bank, Amount of Overdraft .	600 0 0
		„ Balance carried down . .	685 0 0
	£2025 0 0		£2025 0 0
To Balance brought down . . .	£685 0 0		

IV. *State of Affairs of the Firm.*

Liabilities.		*Assets.*	
To Partners for Advances—		Cash Balance in hand	£685 0 0
A £500 0 0		Deficiency, debited to Partners and to be contributed by them—	
B 400 0 0	£900 0 0	A £366 0 0	
„ Partners on Capital Account—		B 366 0 0	
A £350 0 0		C 183 0 0	915 0 0
B 250 0 0			
C 100 0 0	700 0 0		
	£1600 0 0		£1600 0 0

If the partners were all solvent it would be sufficient that each partner should bring in cash for the amount of the Dr. balance shown on his account above, *i.e.* A £16, B £116, C £83, together £215, which, with the £685 already in hand, would pay off the firm's liabilities to A and B for advances; but C has no funds, and his contribution is thus irrecoverable.

The firm assets being insufficient to repay the capital, it becomes necessary for the partners to contribute the deficiency in the proportions in which they share profits, and it is to be noted that there is no obligation on the solvent partners to contribute also their insolvent copartner's share. The position, therefore, is that A brings in his £366 and B his like share, making the Cash Balance up to £1417, out of which the advances of £900 are first paid, and the balance of £517 is "applied in paying to each partner rateably what is due from the firm to him in respect of the capital, account being taken of the . . . contributions to be made by him towards the deficiency of capital" (*Garner* v. *Murray's case*); that is, between A and B in the ratio of 350 to 250, *i.e.* £301, 11s. 8d. and £215, 8s. 4d. This distribution can be effected in an accounting to obviate the finding of the necessary cash by A and B to make the contributions, thus:—

Cash Balance in hand			£685 0 0
Funds in hand, as above . . .		£685 0 0	
Add—Partners' Contributions recoverable, A £366, B £366		732 0 0	
Funds for division . . .		£1417 0 0	
Against which charge — Partners' Advances		900 0 0	
Leaving to repay Partners on Capital Account		£517 0 0	
A. Advances		£500 0 0	
Capital, 350-600ths of the £517 .		301 11 8	
		£801 11 8	
Deduct—Contribution payable . .		366 0 0	
		£435 11 8	
B. Advances . . .	£400 0 0		
Capital, 250-600ths of £517 . . .	215 8 4		
	£615 8 4		
Deduct—Contribution payable . .	366 0 0	249 8 4	
			£685 0 0

Assume the case of the same firm, A, B, and C, with the State of Affairs at the commencement of the winding-up, showing one partner, C, indebted to his firm by reason of heavy trade losses or excessive drawings, thus:— **Third Case.**

Balance Sheet of the Firm of A, B, & C at commencement of Winding-up.

Liabilities.			*Assets.*	
Trade Creditors .		£700 0 0	Book Debts . .	£1500 0 0
Bank		600 0 0	Stock in trade . .	1000 0 0
Advances from Partners—			Plant, &c. . .	375 0 0
A .	£500 0 0		Cash Balance . .	25 0 0
B .	400 0 0	900 0 0		
Capital—				
A .	£450 0 0			
B .	350 0 0			
	£800 0 0			
C, Dr.	100 0 0	700 0 0		
		£2900 0 0		£2900 0 0

The Assets are sold to X and Y for £2000, and the accounts n the winding-up then stand as follows:—

I. *Realisation Account.*

Dr.	*Cr.*
All as in last case.	

II. *Partners' Accounts.*

1. *A's Capital Account.*

Dr.		*Cr.*	
To $\frac{2}{5}$ths Loss on Realisation . .	£366 0 0	By Balance brought forward . . .	£450 0 0

2. *B's Capital Account.*

Dr.		*Cr.*	
To $\frac{2}{5}$ths Loss on Realisation . .	£366 0 0	By Balance brought forward . . .	£350 0 0

3. *C's Capital Account.*

Dr.		*Cr.*	
To Balance brought forward . . .	£100 0 0		
" $\frac{1}{5}$th Loss on Realisation . .	183 0 0		

III. *Cash Account.*

Dr.	*Cr.*
All as in last case.	

IV. *State of Affairs of the Firm.*

Liabilities.			*Assets.*		
To Partners for Advances—			Cash Balance in hand		£685 0 0
A .	£500 0 0		Due by Partner C .		100 0 0
B .	400 0 0		Deficiency debited to Partners—		
		£900 0 0	A .	£366 0 0	
To Partners on Capital Account—			B .	366 0 0	
A .	£450 0 0		C .	183 0 0	
B .	350 0 0				915 0 0
		800 0 0			
		£1700 0 0			£1700 0 0

C is unable to pay anything either towards his indebtedness on his overdrawn Capital Account or towards the contribution of £183 due by him. The position thus is:—

Cash Balance on hand			£685 0 0
Funds in hand		£685 0 0	
Add—			
Contributions recoverable from A and B		732 0 0	
Funds for division . . .		£1417 0 0	
Against which charge—Partners' Advances		900 0 0	
Leaving to repay Partners on Capital Account		£517 0 0	
A. Advances		£500 0 0	
Capital, 450-800ths of £517 . .		290 16 3	
		£790 16 3	
Less, Contribution payable . .		366 0 0	
		£424 16 3	
B. Advances	£400 0 0		
Capital, 350-800ths of £517 . . .	226 3 9		
	£626 3 9		
Less, Contribution payable . . .	366 0 0		
		260 3 9	
			£685 0 0

Limited Partnerships.—At Common Law every partner is liable for the whole debts of his firm, with right of relief against his copartners for their shares of firm debts discharged by him. Under the Partnership Act of 1890, sec. 3, if any person lend money to another in trade in consideration of receiving a share of the profits or at a rate of interest varying with the profits and the latter become insolvent, the lender is not entitled to rank on the insolvent's estate until the other creditors have been satisfied. Such lenders may be safeguarded against liability as partners for the firm's debts by having the contract between them and the borrowing firm put

in writing, under sec. 2, subsec. 3 (*d*). But apart from contracts merely to lend money, "sleeping partners" were liable for the whole obligations of the firm, and to afford a method of enabling persons to become lenders for a share of profits and with certain partners' rights without incurring partners' unlimited liability the Limited Partnerships Act of 1907 was passed. The Act provides that limited partnerships must be registered with the Registrar of Joint Stock Companies, among the particulars prescribed for registration being the names of all the partners and the sums which the limited partners are liable to contribute to the firm. The partners who are liable for the whole firm's debts are called "general partners," and those with limited liability "limited partners." The latter must not, on penalty of forfeiting their limited liability, participate in the management of the firm's business.

VII.—JOINT STOCK COMPANIES

A Joint-Stock Company is a registered firm with a fixed amount of joint stock or capital in certain specified shares. These Companies must be registered under the Companies Acts. The members may have their liability for the Company's debts limited to specified sums guaranteed by them individually, or to the specified nominal value of the shares or stock held by them. The Companies Acts require companies to keep certain books containing the records of their membership and administration, but these statutory books are statistical, not financial, and they are therefore only named here and the reference given to the section of the Companies Consolidation Act prescribing them. The student can refer to the sections given should he desire to learn what these books are required to contain.

Statistical Books.

The statutory books are—

1. Register of Members (Sec. 25).
2. Annual List of Members and Summary (Sec. 26).
3. Register of Mortgages (Sec. 100).
4. Minute Book (Sec. 71).
5. Register of Directors and Managers (Sec. 75).

Company Finance Generally.

A partnership is regulated by its Contract or Articles of Copartnership, a company is regulated by its Articles of Association. The commonest case of a company is what is ordinarily termed a "limited liability

"Limited."

company," with its capital divided into shares of a specified amount. Thus, a trading company may adopt the name "Traders, Limited," and have a capital of 10,000 shares of £1 each. The word "Limited" forming part of the name is to give notice to the world that the liability of the members of the company is limited to the amount of their shares. The holder of 100 shares in such a company is only liable for £100 of capital towards it, even if some of the company's creditors should go wholly or partly unpaid.

Commonly, when such a company is being formed, the public are invited to subscribe for its shares, and a Prospectus is issued. Enclosed therewith is a form of Application for Shares, and those desiring to become contributories fill up the application and hand it over to the banker whose name is indicated thereon, together with cheque or cash as a first instalment of the sum payable on the shares applied for. The Company gets all these Applications from its bankers, and then proceeds to allot or appropriate the shares to the various applicants. A Letter of Allotment is sent to each of the applicants intimating the number of shares allotted. When the banker gets payment from the applicants of the sums payable on their several applications, he credits the company's account, as the money is being paid in for its behoof. When the Company receives the bundle of Applications it ascertains the amount paid in by the applicants, and makes a corresponding entry in its books, debiting its bankers as receivers, and crediting Applications Account. If the amount paid in on application is all appropriated towards shares, an entry is made debiting Applications Account and crediting Capital Account, thereby transferring to Capital Account this first instalment of the Capital of the Company. A company's capital is usually payable in instalments due—1st, On Application; 2nd, On Allotment; and the remainder as called up by the Directors. In our illustration we regarded a share as of the nominal value of £1; this might be payable—2s. 6d. per share on Application, 5s. on Allotment, and the balance in calls of not more than 5s. at intervals.

Application.

When the Allotment Letters have been issued the second instalment of the capital is payable, and a special account for

this instalment is opened. Thus, if the whole 10,000 shares have been allotted, and 5s. per share is payable on allotment, the instalment due under this head is £2500. Allotment Account is debited and the Capital Account credited with this sum. As the amounts due on allotment are paid into the Company's bankers a counterpart of the receipt form is retained by the bankers and handed to the Company, from which it is seen which contributories have paid the amount due by them. By these daily advices, too, it is found what has been the daily total paid into Bank by contributories, and a daily entry is made debiting Bank and crediting Allotment Account with the daily collections under that head. As the Allotment Account has already been debited with the total receivable in respect of that instalment, and is now being credited with the amounts received through the bank in settlement thereof, it is evident that any balance on the account must be a Dr. balance representing Allotment payments still outstanding.

Allotment.

When a further instalment of the Capital is required, the Directors resolve to call up another payment on the shares. The call is made by such resolution, and an intimation is then sent to every contributory demanding the sum due by him on such call. When the resolution is passed calling up so much per share, a cross-entry should be made debiting a special account for First Call or Second Call, or as the case may be, and crediting the Capital Account with the sum which such call should realise. To revert to the previous illustration—if 2s. 6d. per share be called up, debit First Call Account and credit Capital Account with £1250, and as the sum due by the shareholders is paid into Bank, Bank is debited and First Call Account credited. Similarly with the subsequent calls. Any balances on these Call Accounts must be Dr. balances; they represent the arrears due in respect of the several instalments.

Calls.

The Capital Account proper thus has at its credit the amount of the capital called up, and any arrears of calls stand at the debit of the particular Call Accounts to which they belong. Occasionally a contributory pays down immediately on allotment the whole sum he could

Adjusting Entries.

afterwards be called upon to pay. The uncalled amount so received should be carried to a special account for Prepaid Calls or Advances against Calls, and when a call is actually made the amount so prepaid belonging to that call should be transferred in the Company's books. This Prepaid Calls Account must have a credit balance on it representing the sum prepaid by contributories in respect of future calls. The item appears in the Company's Balance Sheet as a separate liability and is in effect a loan by these prepaying contributories to the Company, on which interest may or may not be payable in terms of the Articles of Association. Sometimes the shares offered for subscription are over-applied for, and the deposits paid by unsuccessful applicants returned to them. These repaid deposits are credited to Cash or Bank and debited to the Applications Account previously referred to. Where a less number of shares is allotted than has been applied for, the excess application deposit is appropriated towards the sum due on allotment. In such a case a transfer between the two accounts secures the adjustment—thus, debit Applications Account and credit Allotment Account. The net balance on the Applications Account, which is left to be carried to Capital Account, should always be equal to the deposit on Application on the whole shares allotted.

In Company matters generally different terms relating to Capital are employed, each one of which has its own significance.

Capital Terms.

Thus, the *Nominal Capital* is the Capital with which a company is registered. The company may be to develop its resources gradually, and therefore offers for subscription only a part of its nominal capital—the amount it is thus prepared to allot is the *Issued Capital.* The response to the appeal for subscription to its shares may not result in the whole portion offered being subscribed—the part actually taken up is the *Subscribed Capital.* Of this subscribed capital a part payment of each share may be sufficient for present purposes, and the balance is left to be called up by the Directors when required—the amount actually called up is the *Called-up Capital.* The shareholders may not without exception pay the calls on their shares, so there may be calls in arrear—the called-up capital minus those calls in arrear gives the amount paid up, or the *Paid-up Capital.*

The two principal classes of shares most frequently met with in companies' accounts are the Preference and Ordinary. The Ordinary Shares are those which have neither special privileges or preferences attaching to them, nor are under any specific disadvantage. In the majority of companies they constitute the only class of shares issued. The Preference Shares are those which carry with them a preference over the Ordinary Shares. This preference may be of three kinds—

Preference and Ordinary Shares.

1. Priority of payment of capital in a winding-up.
2. Preference with respect to dividend.
3. A combination of these two preferences.

In the event of a company being dissolved, the shareholders' claim for repayment of the capital they have put in, both Preference and Ordinary, is deferred to that of the Company's creditors, but when the creditors have been fully satisfied, the remaining assets fall to be divided among the shareholders. If these assets are insufficient to pay out all the shareholders' capital, then the question of preference between the classes of shares comes to be considered. According to the terms of the Articles of Association the preference shares may be entitled to repayment in full before the ordinary shares can claim to be repaid anything. This is the priority of payment of capital in a winding-up (*i.e.* in a dissolution or liquidation).

Another preference which a certain class of shares may carry is a claim to dividend up to a specified rate before the ordinary shares are entitled to participate in the divisible profits. The nature and extent of all preferences are set out in the Articles of Association, and they must be carefully studied in each particular case. Frequently preference shares are entitled to draw a dividend in respect of every year or half-year, and if there be no profit in any period out of which to pay such preference dividend, these shares carry forward their claim for that unpaid dividend until there are divisible profits to meet it. Each period's dividend is not in such a case a claim on that period's profit only, but on any profit available for its satisfaction. So long as any such claim to arrears of preference dividend exists, the ordinary

shareholders have no claim to share in the profits. When shares carry a preference of this kind, they are properly distinguished by the name "Cumulative Preference" shares, but it has been decided that all preference dividends are cumulative unless specifically restricted.

Cumulative Preference.

The third class of preference share combines the privilege of priority in repayment of capital on a winding-up with the preference to a dividend out of the first available profit to the exclusion of the ordinary shares.

When there are other classes of shares than those named, the Company's Memorandum and Articles of Association must be carefully studied to ascertain the preferences and rights attaching to each class.

When an individual borrows cash for business purposes he grants his bond, his written acknowledgment of his indebtedness, containing the terms of the loan and general conditions of the bargain, and the stipulations for repayment, and makes over such security as may have been agreed on between him and the lender. For all practical purposes a Company's debentures may be regarded as its bonds for borrowed money—they are a liability of the company to the lenders. They are usually issued in a series all of the same tenor. When the company makes over all or any part of its floating assets in security for such debts, these assets are mortgaged or held hostage for the redemption of the debentures, and the debentures are then spoken of as "Mortgage Debentures." This class of item is seldom met with in Scottish companies, as Scots Law does not recognise a floating charge over moveable property, and heritable subjects only may therefore be given in security; but these debentures are much in evidence in English companies' accounting.

Debentures.

Companies' Accounts.

In the books of a private trader there were no adjustments to consider, no distinctions and allowances to make; in partnership, the provisions of the Contract of Copartnership as to the allocation of the profits had to receive effect; and

now in the case of a company the provisions of the Articles of Association as to the appropriation of the profits must be complied with.

In a private concern the profit for the period is ascertained on the Profit and Loss Account and transferred thence to the Capital Accounts. A Company's capital has a nominal value in shares, and is therefore more or less a fixed item. The Profit and Loss Account balance, whether profit or loss, is not carried to Capital Account, and does not augment or reduce the balance on Capital Account. It is thus necessary to carry forward on the Profit and Loss Account the balance of profit or loss, and a third division of the account is commonly kept for this purpose. A specimen of such a section of the Profit and Loss Account appears thus:—

Mar. 15.	To Dividend at 8 per cent. .	£600	0	0	Jan. 1.	By Balance, being undivided Profit brought forward	£937	16	3
	„ Reserve Fund .	200	0	0	Dec. 31.	„ Net Profit for year per Profit and Loss Account	742	18	1
Dec. 31.	„ Balance carried forward	880	14	4					
		£1680	14	4			£1680	14	4

The balance entered in the foregoing example at 1st January was the profit available for division at the close of the previous year's accounts, and it is entered in this section of the account so that the preceding section might be exclusively kept to bring out the year's profit.

Appropriation of Profits.

After the completion of the accounts the Company's "Annual General Meeting" was held, at which the shareholders resolved—(1) to pay a dividend at the rate of 8 per cent. on their called-up capital of £7500; (2) to reserve £200; and (3) to "carry forward" the balance of £137, 16s. 3d. This section of the account shows how the profits have been appropriated, and it derives its name "Appropriation Account" therefrom. "Net Profit Account" is

also sometimes applied. When the resolution appropriating the divisible profits in such manner was passed, an entry was made debiting the Appropriation Account and crediting a Dividend Account with the sum required to meet the dividend resolved upon. This Dividend Account is debited with the amounts of the cheques or "Dividend Warrants" issued to the several shareholders, the complementary credit being made in the Bank Account. While any shareholder's dividend is unpaid for any reason, the Dividend Account must have a Cr. balance of that amount, and, being a credit, the amount would appear in the Balance Sheet as a liability for Unclaimed Dividend.

The Reserve Fund entry is for the transfer out of the account of divisible profits to an account of reserved profits. The shareholders elect to leave at the Company's disposal part of the profits which they might claim to have divided as additional dividend, but as the withdrawal of so much cash in dividend might hamper the business, they prefer to draw a dividend at 8 per cent., and specifically reserve £200. The balance of undivided profit is not appropriated, it is merely carried forward to next period's account.

The Net Profit for the year just closed, as brought out in the Profit and Loss Account, is credited as going to increase the fund available for appropriation.

The foregoing Appropriation Account might be recast in the following form to give a more accurate conception of the effect of the appropriation of profits:—

Dec. 31. To Balance carried down, being undivided profit at this date .	£880 14 4	Jan. 1. By Balance brought forward .		£937 16 3
		Mar. 15. „ Deduct — Dividend at 8 per cent.	£600	
		Reserve Fund .	200	
				800 0 0
		Carried forward		£137 16 3
		Dec. 31. By Net Profit for year brought down . .		742 18 1
	£880 14 4			£880 14 4

Preliminary Expenses.

The registration fees, legal expenses, and other outlays in connection with the formation of a company are very heavy, and where the Company, not the vendor, pays these charges, it is unfair to the company's prospects to charge the whole amount against the first year's profits. These Preliminary Expenses are accordingly posted to an account carrying that name, and the Articles of Association give the Directors power to write off the amount by instalments over a period of years. The balance of Preliminary Expenses unwritten off at any date stands on the company's books as a Dr. balance, and appears in the Balance Sheet an asset—an asset, not because any part of the outlay is recoverable, but because one year has a claim on the future year's profits, for the benefit to be derived from these initial charges. It is, of course, most desirable to write off the Preliminary Expenses as speedily as possible, but that is a matter of policy for the board of Directors rather than the book-keeper. The Preliminary Expenses Account might appear in the books as shown in the following example, assuming that they have amounted in all to £270, and it has been resolved by the Board to spread the charges over three years in equal portions. The amount written off annually is debited to the year's Profit and Loss Account, and the balance uncharged is carried down to the new account and shown in the Balance Sheet as an Asset. Example:—

Preliminary Expenses.

Dr.		*Cr.*	
Jan. 13. To Cash paid B L, Law Charges and Outlays .	£160 0 0	Dec. 31. By Profit and Loss Account .	£90 0 0
Feb. 11. „ Cash paid C A, fees for Report and professional services .	52 10 0	„ Balance .	180 0 0
„ 27. „ Cash, Brokers' Commissions, etc. . .	57 10 0		
	£270 0 0		£270 0 0

Preliminary Expenses—continued.

	Brought forward .	£270 0 0		Brought forward .	£270 0 0
Jan. 1.	To Balance .	£180 0 0	Dec. 31.	By Profit and Loss Account .	£90 0 0
				„ Balance .	90 0 0
		£180 0 0			£180 0 0
Jan. 1.	To Balance .	£90 0 0	Dec. 31.	By Profit and Loss Account .	£90 0 0

A shareholder in a company is usually at liberty to dispose of his holding by transferring his shares to another party. He does so by executing a "Deed of Transfer" and having this deed sent to the company's office for registration. The shares are transferred in the Register of Members from the transferror to the transferee's name, but this does not affect the financial books. When such a transfer is received for registration, however, a fee of 2s. 6d. or 5s. is usually remitted as a fee for registering the change. These fees are credited to a Transfer Fee Account, which account is written off to Profit and Loss Account as a profit when the books are being closed for the period.

Transfer of Shares.

The following example of a company's accounts and relative Balance Sheet gives the student an idea of the general principles of setting out such statements:—

Example of Accounts.

Goods Account.

Dr.					*Cr.*
Jan. 1.	To Stock on hand	£5,000 0 0	Dec. 31.	By Sales	£16,129 8 6
Dec. 31.	„ Purchases	11,796 13 5		„ Stock on hand .	3,800 0 0
	„ Gross Profit on Trading	3,132 15 1			
		£19,929 8 6			£19,929 8 6

Profit and Loss Account.

Dr.					*Cr.*
Dec. 31.	To Wages and Salaries	£1500 0 0	Dec. 31.	By Gross Profit on trading	£3132 15 1
	„ Rent, Rates, and Taxes .	163 6 8		„ Discounts on Purchases .	21 9 8
	„ Carriages and Freights	72 11 4		„ Transfer Fees .	3 2 6
	„ General Charges	349 2 11			
	„ Discounts and Bad Debts .	116 15 9			
	„ Interests and Bill Discounts .	87 12 6			
	„ Interest on Debentures	50 0 0			
	„ Directors' Fees .	75 0 0			
		£2414 9 2			
	„ Net Profit for year, carried down .	742 18 1			
		£3157 7 3			£3157 7 3
Mar. 15.	To Dividend at 8 per cent. .	£600 0 0	Jan. 1.	By Balance, being undivided profit brought forward	£937 16 3
	„ Reserve Fund .	200 0 0	Dec. 31.	By Net Profit for year from Profit and Loss Account	742 18 1
Dec. 31.	„ Balance carried forward	880 14 4			
		£1680 14 4			£1680 14 4

Balance Sheet as at 31st December.

Liabilities.			
I. Due to Creditors on Open Account .	£172 11 7		
II. Bills Payable . .	385 12 6		
III. Bank Overdraft .	472 9 11		
IV. Debentures at 5 per cent. . .	1,000 0 0		
V. Due to Shareholders—			
1. Capital—10,000 shares of £1 each, of which 15s. per share called up	£7,500 0 0		
2. Reserve Fund .	800 0 0		
3. Undivided Profit .	880 14 4		
		9,180 14 4	
		£11,211 8 4	

Assets.		
I. Book Debts . .	£4,713 13 4	
Less—Reserve for Bad Debts and Discounts at $1\frac{1}{2}$ per cent. .	70 14 0	
	£4,642 19 4	
II. Bills Receivable	1,249 10 3	
III. Stock on Hand .	3,800 0 0	
IV. Plant and Fittings . . .	276 8 3	
V. Goodwill, at cost .	1,200 0 0	
VI. Cash on Hand .	17 10 6	
VII. Calls in Arrear .	25 0 0	
	£11,211 8 4	

The arrangement of the foregoing Balance Sheet is on lines similar to our previous illustrations. Appended to the 1862 Companies Act there was a set of model Articles of Association known as Table A, which was binding on all Companies which had registered no special Articles, and in such Table A was a form of Balance Sheet to be conformed to as near as circumstances admitted. Many Companies on which Table A was not binding framed their Balance Sheets on this model, and although that Table A was superseded by a new Table A issued in July 1906 in which no form of Balance Sheet appears, the arrangement of the original Balance Sheet is still retained by these Companies. The student must therefore consider that arrangement, of which the following example, being the foregoing Balance Sheet recast, is illustrative:—

Balance Sheets.

BALANCE SHEET of TRADERS, LIMITED, made up to 31st December.

Dr. *Cr.*

Capital and Liabilities.		
I. Capital—		
10,000 Shares of £1 each, of which 15s. per share called up . . .		£7,500 0 0
Less— Arrears of Calls . .		25 0 0
		£7,475 0 0
II. Debts and Liabilities—		
Debentures . .	£1,000 0 0	
Bills Payable . .	385 12 6	
Creditors' Accounts	172 11 7	
Bank Overdraft .	472 9 11	
		2,030 14 0
VI. Reserve Fund		800 0 0
VII. Profit and Loss Account— Undivided Profit		880 14 4
		£11,186 8 4

Property and Assets.		
III. Property Held by the Company—		
Stock in trade		£3,800 0 0
Plant and Fittings		276 8 3
Goodwill		1,200 0 0
		£5,276 8 3
IV. Debts Owing to the Company—		
Bills Receivable .	£1,249 10 3	
Book Debts (less Reserve £70, 14s.)	4,642 19 4	
		5,892 9 7
V. Cash on Hand		17 10 6
		£11,186 8 4

No inflexible rule can be laid down for the arrangement of the items in a Balance Sheet; the circumstances of each case must receive consideration. So far as possible, however, the arrangement should conform to the style best understood by those interested in the Company's affairs as creditors and shareholders.

Reserves, Reserve Fund, and Sinking Fund.

Certain classes of Reserves have already been dealt with, and Reserve Fund has just been alluded to relative to joint stock companies' accounting. Familiar instances of reserves are those for bad debts and customers' discounts. These may be met with in the books of private traders, firms, and companies, but a reserve fund, a general reserve against no specified contingency, is peculiar to company book-keeping. From what has already been said with reference to these items under their respective heads, it is obvious that there is a clear distinction between a Reserve for a specific purpose and a Reserve Fund.

Reserves.

Reserves are Charges against Profits to provide for Contingent Loss under Specified Heads.—They are adjustments between trading periods in respect of possible losses incurred in one period, but not definitely ascertained until some future time. A Bad Debt Reserve, for example, is a charge against the expiring year's profits to provide for the loss in bad debts of certain of the book debts being carried forward from that year. This appropriation to some special purpose is a characteristic of reserves, properly so called. The book-keeping entry for a reserve such as a Bad Debt Reserve is, Profit and Loss Account Dr. to Bad Debt Reserve Account, or it might be more properly passed through the Bad Debt Account instead of being debited direct to Profit and Loss Account. All reserves are specifically provided for a contingent reduction of some asset, and every reserve always stands on its own account as a Cr. balance. Reserves might therefore appear in the Balance Sheet as liabilities; but being so ear-marked as attaching to specific assets, it is better to deduct them from the assets to which they are related, and to carry out the net values of such assets.

Reserve Fund.

A Reserve Fund is an Appropriation of Profits—it is a Portion of the Divisible Profits Ear-marked as "Reserved."—Profits might be wholly paid away in dividend to the shareholders, but with a view to strengthening the company's position the shareholders may appropriate only a portion of the divisible profits to dividend and set aside or *reserve* another portion. This reserved portion is not left as a balance on the Profit and Loss Account but is transferred to a special account commonly called Reserve Fund, but more properly "Reserve Account." "Reserve Fund" conveys the idea of an accumulation of assets, whereas "Reserve Account" is the account on which appears the Cr. balance for the liability to the shareholders in respect of the withheld or reserved profits. The reserving of these profits has assuredly resulted in the Company's assets being greater than they would have been had nothing been reserved, because all would have been distributed as dividend; in other words, the actual "fund" consists in surplus assets, either in the business by way of increases in its floating assets or outside of the business by way of investments, but the Reserve Account is the liability for reserved profit, and accordingly a Cr. balance on the books. *Reserves* are provisions for contingent but unascertained trading losses, losses which are inseparable from trade, and which therefore must be regarded as chargeable to Profit and Loss Account like other incidental expenditure. A *Reserve Fund* is not a charge against profits, but an allocation or appropriation of profits earned. The book-keeping entry for a transfer to the Reserve Fund is Profit Appropriation Account Dr. to Reserve Fund Account. The Reserve Fund is invariably a Cr. balance on its account and therefore appears as a liability in the Balance Sheet.

Occasionally the Reserve Fund is invested outside the company's own business, but this does not affect its character. When such an investment is made, the entry is, Investment Account Dr. to Cash or Bank, according as the payment is made in cash or by cheque. The Investment Account thus shows a Dr. balance, and is included as an asset in the Balance Sheet. In such a case the Reserve Fund stands as a liability and the Investment held in connection therewith as an asset.

The *raison d'être* of a sinking fund is the necessity for pro-

viding available cash to meet some heavy liability, which, without such foresight and accumulation, would be too great a drain upon the resources of the payer. The Sinking Fund is formed by the withdrawal from the ordinary course of business sums of cash, which are set aside and independently invested. When the liability for which the fund has come into existence matures, the investment is realised and the proceeds applied to the redemption of the debt. The entry for each withdrawal for sinking fund purposes is obviously Sinking Fund Account Dr. to Cash or Bank; for the interest accruing on the investment and being added thereto, Sinking Fund Account Dr. to Interest Account; for the realisation of the investment, Cash or Bank Dr. to Sinking Fund Account; and finally, for the redemption of the debt, the Debentures or other account on which the liability stands Dr. to Cash or Bank. The real use of a Sinking Fund, then, is to accumulate ready cash to meet some heavy liability; unless some such method were adopted the floating cash balance would not provide a sufficient sum for the redemption of the debt. To render possible such an accumulated sum it is a common practice of joint stock companies to appropriate to Reserve Fund a portion of each period's profits, the effect of which appropriation is to pay away less in dividend than would otherwise be done. The surplus cash left in hand by the smaller dividend being paid is then invested, and such investments are afterwards realised to provide the funds with which to pay off the Debentures or other liability maturing. The most familiar instances of Sinking Funds are the following:—first, of a joint stock company to redeem debentures; second, of a manufacturing concern for the renewal of boilers or other costly wasting asset; and third, of a local authority for the repayment of its loans. In each of these cases the principle is the same: an instalment must be taken out of the floating cash balance and invested independently, so that when the liability falls to be met or the asset renewed, the proceeds of the investment are available, and the ordinary course of the business goes on unhampered.

Sinking Fund.

VIII.—SINGLE ENTRY

In the application of the principles of double entry there is no exception to the rule that every debit has a corresponding credit entry somewhere in the book-keeping system. The significance of the term double entry is in this invariable principle, but it is not to be assumed that single entry, by analogy, is a system of book-keeping by which every transaction has only a debit or a credit entry. This is not so; single entry may rather be defined as any method of book-keeping which is not complete double entry. This negative definition is very wide, but it is necessarily so to embrace all the partial systems of book-keeping in vogue in different businesses. The features commonly found in these partial systems, which we shall now call single entry sets of books, are best studied by reference to the double entry records. The following outline of how single entry books may be kept may be regarded as indicating the irreducible minimum of book-keeping; so-called single entry embraces every partial system from this minimum up to a state of completeness just short of double entry. After grasping the fundamental principles of dealing with such scrappy records, it is a simple matter to abstract and marshal the facts and figures obtainable from books in all degrees of imperfection. We shall examine the ledger accounts first and then proceed to the investigation of the books of original entry.

The trader who adopts double entry makes his business keep a complete system of records so as to show its position as an identity apart from himself, and he regards himself as its creditor to the extent of the balance due him on capital account; but the trader who keeps his books by single entry identifies himself with the business and merely keeps records of his dealings with outsiders so that he may see whether they are his debtors or creditors and by how much. The single entry trader says that what is not owed to

Ledgers.

his creditors nor by his debtors concerns himself only. On this ground he dispenses with the use of the real accounts in which would be recorded the In-comings and Out-goings of the different kinds of property, and he also dispenses with the nominal accounts and keeps no systematic record of the various heads of profit and loss. His ledger accounts therefore embrace his debtors on the one hand and his creditors on the other. When the book-keeping system of a business is reduced to so-called single entry even the books kept are ordinarily in an incomplete state. Houses doing a good trade sometimes keep no Creditors' Ledger beyond the invoices on a spike file, which are transferred to another file when the accounts are paid.

Invoice Book.

As to the books of original entry, they are usually kept only to the extent necessary to keep those personal accounts written up, and also to supply any special items of information which the trader may wish for the sake of comparison. The Invoice Book, when it is kept at all, is written up from the invoices received as before, and the individual items appearing therein are posted to the credit of the personal accounts of the sellers. There is no Goods Account kept, however, and it is not therefore necessary to sum the Invoice Book to ascertain the month's total, and it is very often left unsummed.

Day Book.

The Day Book is similarly treated; the sales to customers are passed through it as before and separately debited to the personal accounts of the customers receiving the goods. The total sales for the month are not to be carried to a Goods Account, and the Day Book may, so far as this consideration goes, be left unsummed. The trader, however, sometimes adds up the Day Book so as to keep a comparative record of his turnover over the different periods.

Returns Books.

If a business be a comparatively large one, it will probably be necessary to keep the usual returns books for returns inwards and outwards. The individual items are posted to the debit of creditors to whom goods were returned outwards and to the credit of customers returning goods inwards, but the totals of these books are not carried to a Goods Account as in double entry.

Bill Books.

The bill books can be kept as in double entry, every bill

receivable being credited to the personal account of the giver and every bill payable debited to the personal account of the receiver. No ledger accounts are kept for bills receivable and bills payable.

Cash Book.

A Cash Account is a property account in itself, but it cannot conveniently be dispensed with, because the difference between the Dr. and Cr. sides always serves to verify the cash on hand. Further, the entries in the Cash Book so far as they relate to cash received from customers and cash paid to creditors must be posted to the ledger accounts. On the Dr. side of the Cash Book are the entries for cash received from customers in settlement of their accounts, cash received for cash sales, and cash receipts of an unusual nature, such as additional capital put in by the partners. Every Dr. cash entry which affects the relations of a person with the business, whether customer or partner, must be posted. Accordingly, customers are credited with the cash they have paid and the discount allowed them, and partners are credited with cash received by the business on their behalf; but beyond this the cash debits refer to real accounts, and they are therefore left unposted. The same principle is applied to the Cr. side of the Cash Book. Every entry which relates to the payment of a creditor's account or to a partner for drawings is posted to the debit of the creditor or the partner, as the case may be, but all payments for cash purchases and also for expenses, which would in double entry be posted to real or nominal accounts, remain unposted, as no real or nominal accounts are kept.

Statement of Assets and Liabilities.

From such meagre records of his business transactions a detailed Profit and Loss Account cannot be prepared, nor can the books be proved by bringing them to a balance. At the close of the financial period it is desired to ascertain the profit and draw up a statement of the assets and liabilities to show the position of affairs. This statement of assets and liabilities just referred to cannot properly be termed a balance-sheet, because it is not a statement of the balances taken off a double entry set of books, but the term balance sheet is nevertheless generally applied to it. The form of such a statement might be as follows in the case of a small trader:—

STATEMENT of ASSETS and LIABILITIES as at 30th June.

Liabilities.				*Assets.*			
Creditors' Accounts, per List of Balances	£371	3	11	Due by Customers, per List of Balances .	£765	2	10
Capital . . .	1000	0	0	Stock on Hand, per Stock Sheets . .	411	8	7
				Plant and Fittings .	116	11	8
				Cash at Bank . .	72	3	4
				Cash on Hand . .	5	17	6
	£1371	3	11		£1371	3	11

We shall now examine these items to ascertain the source of the trader's information in preparing such a statement, considering that his books show him so very little. The creditors' and customers' balances are obtained from the personal accounts kept in the Ledger. Two lists of the balances are prepared, the one for the creditors' accounts and the other for the customers' accounts. The value of the stock on hand is arrived at by the ordinary method of preparing an inventory of the goods actually on hand and pricing it out at cost. The plant and fittings may be valued arbitrarily, or the figure appearing in the previous statement may be adopted plus any additions during the period and minus any allowance to be made for depreciation. The balance of cash at bank can be got from an account kept in the ledger as a personal account in the name of the bankers, but some traders keep their Bank Account in the bank pass-book only, from which source this balance could be got. The cash on hand is the balance on the Cash Book, and should agree with the cash actually on hand at the date of the statement. The capital is simply the balance on the statement itself; it does not agree with the balance brought out on any account. The excess of the assets over the liabilities is the amount of capital in the business.

Assuming that the foregoing is a statement of the position of a business at 30th June, and that the books are being closed for the half-year ending 31st December, it is required to ascertain the profit earned for the half-year. The first step is to prepare a statement of assets and liabilities as at 31st December on the same lines as the foregoing statement, thus:—

STATEMENT of ASSETS and LIABILITIES as at 31st December.

Liabilities.				*Assets.*			
Creditors' Accounts, per List of Balances	£291	7	6	Customers' Accounts, per List of Balances	£795	8	4
Capital at this date .	1145	1	4	Stock on Hand, per Valuation . .	424	9	3
				Plant and Fittings, per last Statement .	116	11	8
				Cash at Bank . .	95	6	4
				Cash on Hand . .	4	13	3
	£1436	8	10		£1436	8	10

The items in the above statement are similar in their nature to the items already examined in detail, and they therefore call for no comment. The next step is to frame the Capital Account. We cannot prepare a Profit and Loss Account because we have kept no nominal accounts, but in a Profit and Loss Account the net profit would have been debited and carried to the credit of the Capital Account, so that if we are given all the other items appropriate to the Capital Account the net profit will be the amount required to balance that account. We can therefore proceed with the Capital Account, thus:—

Ascertainment of Profit.

CAPITAL ACCOUNT (bringing out the Profit for the half-year ending 31st December).

Dr.						*Cr.*					
Dec. 31.	To Cash drawn during the half-year per Drawings Account kept. .	£121	6	8		June 30.	By Balance, being Capital as per Statement of assets and liabilities as at this date .	£1000	0	0
	„ Capital at this date, as per Statement of assets and liabilities as at this date .	1145	1	4		Dec. 31.	„ Difference on this account representing the net profit for the half-year .	266	8	0
		£1266	8	0				£1266	8	0

The same result can be arrived at by reasoning thus:—

The capital in the business at 30th June, as per the Statement of assets and liabilities prepared as at that date, was . .	£1000	0	0
During the half-year from 30th June to 31st December the drawings on Capital Account have amounted to	121	6	8
Leaving of the original capital a balance of	£878	13	4
But the capital at 31st December brought out in the Statement of assets and liabilities prepared as at that date is . .	1145	1	4
Showing an increment of	£266	8	0

And such increment must be net profit.

If any fresh capital had been put into the business during the half-year it would have been credited in the Capital Account, and this would have had the effect of reducing the increment in respect of profit.

Partnership. The same method is adopted in single entry book-keeping for a partnership, but the fact that the partners have each a separate Capital Account makes the ascertainment of the profit more complex. The procedure is as follows:—Prepare a Statement of the assets and liabilities as at the date of the balance just as before, and it is to be assumed that a similar statement as at the previous balance exists and shows how the capital was held at that date by the partners. Adopting the same figures as have been used in the last illustration, the accounts would appear thus:—

STATEMENT of ASSETS and LIABILITIES as at 30th June.

Liabilities.				*Assets.*			
Creditors' Accounts, per List of Balances	£371	3	11	Due by Customers, per List of Balances .	£765	2	10
Capital—held thus:—				Stock on Hand, per Stock Sheets . .	411	8	7
A . £650 0 0				Plant and Fittings .	116	11	8
B . 350 0 0	1000	0	0	Cash at Bank . .	72	3	4
				Cash on Hand . .	5	17	6
	£1371	3	11		£1371	3	11

This statement shows in what proportions the capital at 30th

June was held by the two partners A and B. Next we must prepare a similar statement as at 31st December. Thus:—

STATEMENT of ASSETS and LIABILITIES as at 31st December.

Liabilities.				*Assets.*			
Creditors' Accounts, per List of Balances	£291	7	6	Customers' Accounts, as per List of Balances . . .	£795	8	4
Capital—held thus:—				Stock on Hand, per Valuation . .	424	9	3
A (to be ascertained)				Plant and Fittings, per last Statement .	116	11	8
B .				Cash in Bank . .	95	6	4
——	1145	1	4	Cash on Hand . .	4	13	3
	£1436	8	10		£1436	8	10

The information concerning the assets and liabilities of the business derived from the many sources previously alluded to enables us to prepare the statement shown above, but it cannot show us in what proportions the capital of £1145, 1s. 4d. was held by the two partners at 31st December. Before this can be found the profit must be ascertained and the separate capital accounts of the partners prepared, with the ascertained profit credited thereto in the proper proportions. The profit is arrived at by stating, in the form of an account denominated Profit and Loss Account, a capital account for the two partners combined, thus:—

Dr. *Profit and Loss Account.* *Cr.*

Dec. 31.	To total drawings by partners during the half-year to date .	£121	6	8	June 30.	By Capital at this date	£1000	0	0
	„ Capital at this date, per Statement of assets and liabilities.	1145	1	4	Dec. 30.	„ Interest on the partners' Capital Accounts in terms of the Contract of Copartnery	23	3	6
						„ Balance on this account, being the net profit divisible between the partners .	243	4	6
		£1266	8	0			£1266	8	0

After allowing for interest on capital, which is to be separately credited to the individual partners, this account brings out a net profit of £243, 4s. 6d. for the half-year.

Interest on Capital.

The treatment of the interest on capital in this way has the effect of appropriating so much of the profit in respect of that charge, thereby diminishing to that extent the balance of profit available for division in equal or other agreed-on proportions. This sum falls to be divided between the partners in equal shares, and we are therefore now in a position to frame the separate capital accounts of the partners. Thus:—

A's Capital Account.

Dec. 31.	To Cash and Goods during half-year .	£28 11 3	June 30.	By Balance, being capital as per the Statement of assets and liabilities at this date .	£650 0 0
	„ Balance, being capital at this date .	758 17 5	Dec. 31.	„ Interest on Capital Account	15 16 5
				„ One-half of net profit .	121 12 3
		£787 8 8			£787 8 8

B's Capital Account.

Dec. 31.	To Cash and Goods during half-year	£92 15 5	June 30.	By Balance, being capital as per the Statement of assets and liabilities at this date	£350 0 0
	„ Balance, being capital at this date .	386 3 11	Dec. 31.	„ Interest on Capital Account .	7 7 1
				„ One-half of net profit .	121 12 3
		£478 19 4			£478 19 4

The foregoing Capital Accounts of A and B, the individual partners of the firm, show that the balances of capital at their credit at 31st December were—

A	£758 17 5	
and B	386 3 11	
together making up the total capital shown in the Statement of assets and liabilities as at that date		£1145 1 4

The ascertainment of the profit brought out in the form of Profit and Loss Account above can be reasoned out in this way:—

The total capital in the business at 30th June was		£1000 0 0
Out of which the partners have drawn A	£28 11 3	
B	92 15 5	121 6 8
leaving at 31st December . .		£878 13 4
But the capital brought out in the Statement of assets and liabilities as at 31st December is		1145 1 4
showing an increment representing profit of .		£266 8 0
Against this profit there is under the Contract of Copartnery a first charge in respect of interest on the partners' Capital Accounts of		23 3 6
leaving a balance of profit to be equally divided between the partners of		£243 4 6
being A . . .	£121 12 3	
B . . .	121 12 3	
		£243 4 6

Partners' Salaries.

If the contract of copartnery further provide for a salary to either of the partners, it would be treated in the same way as the interest on capital; that is, it must be credited to the Capital Account of the partner entitled to it and also credited in the Profit and Loss Account.

This latter entry has the effect of reducing the unappropriated profit divisible between the partners in equal shares.

Introduction of Double Entry.

To change the single entry system of books to double entry, the first step is to prepare a Statement of the assets and liabilities as at the date on which the change is to be made. Accounts should then be opened for each of the assets and liabilities, the items appearing in the statement as assets being debited to their proper Ledger accounts and the liabilities credited. The customers' and creditors' balances would of course already appear in the Ledger on the personal accounts, and no further entries would be necessary for them nor perhaps also for the cash and bank balances; it would depend on how these had been treated hitherto. As the assets and liabilities in the statement agree in their sum, the total of the assets which have been debited in their appropriate accounts would agree with the total of the liabilities which have been credited in their appropriate accounts, and the books thus open the period on the balance. Every transaction thereafter must receive its full effect in the manner laid down in treating of double entry.

Disadvantages of Single Entry.

From the outlines of single entry it will be seen that it suffers in comparison with double entry on two very important points, viz. first, that as the books cannot be balanced there is no check upon their accuracy nor on the honesty of the employees; and second, that it is impossible to prepare detailed profit and loss accounts for the various periods, and thereby a valuable aid to economies and a fertile source of information are lost to the trader.

Retail Traders' Accounts.

For the small trader there is an admirable system which overcomes this second disadvantage, in the use of an analytical or columnar form of Cash Book. With such a Cash Book and by framing a periodical statement of assets and liabilities from the information derived from the sources previously indicated, it is possible to draw up a Goods Account and Profit and Loss Account in detail, and the various heads of income and expenditure are thus available for comparison with other periods.

The following is a form of Cash Book suitable for such a purpose:—

Analytical or Columnar Form of Cash Book.

Dr. *Cr.*

Other Receipts.	Folio.	Sales.	Discount.	Bank.	Cash.	Date.	Item.	Cash.	Bank.	Folio.	Discount.	Purchases.	Charges.	Wages.	Rent, Taxes, and Insurance.	Other Payments.

Analytical Cash Book.

The foregoing style of Cash Book is kept on principles similar to those already explained, as applied to other rulings of cash books. The cash receipts are entered in the Dr. Cash column, and if they are for cash sales or in settlement of customers' accounts, the amount is also extended to the Sales column. If the receipt is on capital account or in respect of some special item it is carried out to the Other Receipts column. The items in these columns are posted to the personal accounts of the customers or the partners, if they are personal items, but real or nominal items such as cash sales are not posted. The Cr. side is similarly treated; cash payments are entered in the Cr. Cash column and extended to the analytical column to which the payment is appropriate. If the payment be made by cheque the entry appears in the Cr. Bank column instead, and is extended as before. All items which affect personal accounts, whether creditors or partners, are posted, but items affecting only real or nominal accounts appear in their appropriate analytical columns and remain unposted. The balances on Cash and Bank columns are carried down to the new period.

The totals of the Discount columns are not carried to a Discount Account, there being no such account kept in the books. The columns are required for the recording of discounts which have to be posted to the personal accounts of the debtors and creditors. When such a Cash Book has been kept for a half-year, say, and it is desired to ascertain the profit for the period, the Cash and Bank columns are balanced, as explained in treating of Cash Books, and the various analytical columns are summed for the period. It is then possible to prepare from the totals of the analytical columns and the balances of Cash and Bank columns an abstract in the following form:—

Cash Abstract.

ABSTRACT OF THE CASH TRANSACTIONS for the half-year from 30th June to 31st December.

Receipts.

June 30.	To Balances brought forward at this date:		
	Cash at Bank .	£72 3 4	
	Cash on hand .	5 17 6	
			£78 0 10
Dec. 31.	,, Customers' Accounts and Cash Sales .		2495 2 7
	,, Receipts on A's Capital Account		100 0 0
	,, Dividends from Investments		43 4 5
			£2716 7 10

Payments.

Dec. 31.	By Purchases .		£1569 10 4
	,, Charges .		220 8 9
	,, Wages . .		473 12 6
	,, Rent, Taxes, and Insurance . .		131 10 0
	,, A's Drawings		221 6 8
	,, Balances at this date:		
	Cash at Bank	£95 6 4	
	Cash on hand	4 13 3	
			99 19 7
			£2716 7 10

It is obvious that the above Cash Abstract should balance, as the funds in hand at the beginning plus the receipts detailed under the various heads must equal the payments detailed under the various heads of expenditure plus the funds at the end of the period.

With a Statement of the assets and liabilities of the business as at the beginning and a similar Statement as at the end of the half-year, the amount of the sales, purchases, and each of the heads of expenditure can be prepared in detail in the manner illustrated in the following example:—

Goods Account.

Dr.

June 30.	To Stock on hand at this date, per Statement of Assets and Liabilities and also per the Stock Sheets .		£411 8 7
Dec. 31.	,, Purchases: Cash paid during half-year, per Cash Abstract .	£1569 10 4	
	Discounts received per Cash Book . .	98 17 6	
	Add, Creditors' Accounts outstanding at 31st Dec., per Statement of Assets and Liabilities at that date . .	291 7 6	
		£1959 15 4	
	Deduct, Creditors' Accounts outstanding at 30th June, per Statement of Assets and Liabilities at that date . .	371 3 11	
			1588 11 5
	,, Balance on this account, Gross Profit carried to Profit and Loss Account		1000 0 0
			£3000 0 0

Cr.

Dec. 31.	By Sales: Cash received during half-year per Cash Abstract .	£2495 2 7	
	Discounts allowed, per Cash Book .	50 2 8	
	Add, Customers' Accounts outstanding at 31st December, per Statement of Assets and Liabilities at that date	795 8 4	
		£3340 13 7	
	Deduct, Customers' Accounts outstanding at 30th June, per Statement of Assets and Liabilities at that date . . .	765 2 10	
			£2575 10 9
	,, Stock on hand at this date, per Statement of Assets and Liabilities and also per Stock Sheets . . .		424 9 3
			£3000 0 0

Profit and Loss Account.

Date	Particulars			Date	Particulars	
Dec. 31.	To General Charges; cash paid per Cash Abstract.		£220 8 9	Dec. 31.	By Gross Profit from Goods Account	£1000 0 0
	Add, Outstanding at this date, per Statement of Assets and Liabilities		15 0 0		„ Creditors' Discounts . . .	98 17 6
			£235 8 9		„ Dividends from Investments .	43 4 5
	Deduct, Outstanding at 30th June, per Statement of Assets and Liabilities at that date . . .		10 0 0			
			£225 8 9			
	„ Wages per Cash Abstract . .		473 12 6			
	„ Rent, Taxes, and Insurance; cash paid	£131 10 0				
	Add, accrued to date per Statement of Assets and Liabilities	10 0 0				
		£141 10 0				
	Less taken as outstanding at 30th June	15 0 0				
			126 10 0			
	„ Customers' Discounts per Cash Book		50 2 8			
	„ Balance on this account being profit, carried to Capital Account .		266 8 0			
			£1142 1 11			£1142 1 11

The principle involved in the foregoing method of preparing detailed accounts is obvious, but of course the correctness of the Statements of assets and liabilities prepared at the beginning and end of the period is essential to accuracy in the Profit and Loss Account for the intervening half-year. To be more exact, in the ascertainment of the sales as brought out in the Goods Account it would be necessary to take into account any bad debts written off the Customers' Ledger since the previous half-yearly balance. The amount of such debts should be credited in Goods Account to bring out the true sales to agree with the Day Book figure, and then debited in Profit and Loss Account as the loss under Bad Debts, in the same way as the customers' discounts are treated in the example.

IX.—INCOME TAX

INCOME Tax is payable on all incomes over £160 received by persons resident within the United Kingdom, and on the profits of property and trade earned within the United Kingdom by persons resident in other countries. The rate of tax is fixed annually in the Finance Act, which is introduced into the House of Commons in April or May in each year.

General Abatements.

Where the total income does not exceed £160, exemption is allowed; and where it falls between £160 and £700, general abatements are allowed on the following scale:—

Total Income exceeds £160 but does not exceed £400, Abatement of £160.
Total Income exceeds £400 but does not exceed £500, Abatement of £150.
Total Income exceeds £500 but does not exceed £600, Abatement of £120.
Total Income exceeds £600 but does not exceed £700, Abatement of £70.

Joint Incomes.

For Income Tax purposes the joint incomes of husband and wife are regarded as the income of the husband, except where the wife by an independent vocation earns a separate income and the joint incomes do not exceed £500, in which case such earnings are regarded as the wife's separate income in fixing the abatements.

Schedules.

For the purposes of administration the tax is divided into five heads or Schedules, distinguished by the letters A to E. The classification of incomes under these Schedules is, in general terms—

A, Incomes from Ownership of Heritable Subjects, *i.e.* Rents.
B, „ Occupation of Land, *i.e.* Husbandry profits.

C, Incomes from Public Funds, *i.e.* Interests and Dividends from Investments in public funds, such revenue being charged in the hands of the Bankers who pay the interest to the stockholders.
D, „ Trade profits, and, generally, income not properly falling under any of the other Schedules.
E, „ Salaries from appointments.

Taxation at Source.

The principle of taxation of income at its source is applied to the collection of Income Tax, and, as this tends to obscure the incidence of the tax and complicate the handling of Income Tax problems in practice, we shall take an illustration of its working.

X's total income is derived from his ownership of heritable subjects of a Gross Rental of £720. Out of this gross revenue he must maintain the property in repair, and for such purpose a general deduction of one-sixth is made from the gross rental; and, further, he must out of such revenue pay the landlord's rates, for which a varying deduction is allowed. The sum on which X is assessed is accordingly the constructive net income derived by him from the property, thus:—

The Gross Rental is		£720
Less, One-sixth for Repairs . . .	£120	
Rates, say at 1s. 9d. per £ . .	63	
		183
and X's tenants therefore pay Property Tax on, Net,		£537

The tax is, however, on the landlord's income, and X's tenants accordingly deduct the Property Tax from the next payment of rent, handing X the receipts in part payment of the rents. X is thus assessed on his income through his tenants.

Further, suppose that X pays to Y a feu-duty of £57 in respect of these subjects, and also pays to Z interest on a mortgage for £2500 at 4 per cent. These sources of income to Y and Z are also taxed by the assessment of X's rents on which they are burdens, and X, on making his termly payments to Y and Z for feu-duty and interest respectively, deducts tax from each

payment at the rate ruling over the term during which it has accrued.

The net assessment on X's rental as before was . .		£537
Tax is recovered from Y by deduction from Feu-duty of	£57	
and from Z by deduction from Interest of . .	100	
		157
showing a Net Assessment of X on		£380

Further, as this £380 has been wholly taxed before X received it, notwithstanding that under the scale he is entitled to a general abatement of £160, he claims repayment from the Inland Revenue of the tax on this £160. This illustration shows that instead of three several assessments on X, Y, and Z, their incomes from these properties have been taxed by levying the Property Tax (Schedule A) on the income at the source. It also shows that Y and Z are not directly assessed on their incomes from feu-duty and interest; all such sums and also dividends on investments and other stated periodical items are received by the recipients less tax.

Annual Value.

The figure of £537 brought out above, which is the constructive net income from the subjects, is known as the "Annual Value." 6

Life Insurance Abatement.

In addition to such general abatement as a tax-payer may be entitled to, he is allowed an abatement in respect of all life insurance premiums paid by him under policies on the life of himself or his wife up to one-sixth of his total income. This abatement must not be treated so as to affect the amount of the general abatement. Thus—

		Right.		Wrong.
Total Income		£640		£640
Life Insurance Premiums .	£60			60
				£580
General Abatement, on £640	70		on £580	120
		130		
Net tax-bearing income . .		£510		£460

On Trade Profits.

It is relative to the assessment of trade profits under Schedule D that the book-keeper has most to do with Income Tax, and it is under this Schedule that the most complex problems arise. The profit to be returned for assessment is in respect of the Income-Tax year ending 5th April, and as the Return has to be made in the early months of the Income-Tax year, it is clear that the profits then returned cannot be the actual profit for the assessment year. Neither is it the profit for the preceding or any other year—it is a "statutory" profit ascertained by averaging the profits of the three years up to the balance of the books last preceding the opening of the assessment year. If the trade has commenced within three years, the average is over the period since the commencement; and if the trade has been commenced within the year of assessment, the Return should contain the estimated profit to the best of the trader's knowledge and belief. The profits from Quarries, Mines, Canals, and Miscellaneous Dues are assessable under special Rules on Special Forms; these are not embraced by the notes in this Chapter.

Average.

The Income Tax Acts and the rules of Income Tax practice prescribe certain adjustments on the ordinary trade profits before the assessable profits are averaged. These rules are set out on the Return itself, or contained in an accompanying sheet. We shall examine them as to the grounds for such adjustments, and thereafter consider their practical application to accounts. In averaging the three years' profits the following deductions are allowed:—

Deductions Allowed.

1. (*a*) Repairs of Premises; (*b*) Supply or Repair of Implements and Furnishings.
2. Bad Debts and Doubtful Debts.
3. Rent of Business Premises payable by tenant tax-payer.
4. Annual Value of Business Premises occupied by Owner.
5. Disbursements and Expenses wholly for purposes of trade.

Notes on 1 (*a*), 3, *and* 4.—The trader is in one of two posi-

tions as to his business premises—he is a tenant at a yearly rental, or he occupies premises owned by himself. If he is a tenant, the rent payable by him to his landlord is a proper business expense, and therefore falls to be debited to Profit and Loss Account as a deduction allowed. If he is his own landlord he may charge the repairs to the premises and the landlord's rates, which are both landlord's burdens, and further charge the Annual Value of the premises as assessed for Property Tax.

Notes on 1 (*b*).—The deduction allowed for the Supply or Repair of Implements, Utensils, or Articles employed in the trade is limited to a three years' average of such charges. Depreciation on Machinery and plant is not covered by this deduction, but must be treated separately. Traders usually prefer to equalise the charge for repairs and renewals year by year by combining the renewals item with the depreciation charge. As a matter of Income Tax law there is no statutory provision for allowing depreciation on shop fittings and similar assets. The Revenue prefer to have renewals of worn-out fittings charged in the Profit and Loss Account, but if a reasonable fixed percentage is consistently charged, such charge is sometimes allowed by the Surveyor.

Notes on 2.—When debts have been written off to Profit and Loss Account as bad, or a proportion of specific doubtful debts has been so written off, such charge is allowed. It is the custom in most businesses to equalise the bad debt charge by estimating a provision at a percentage on the book debts or on the turnover. Such an item is disallowed for Income Tax purposes, and any increase in such provision in any year must therefore be written back to profits, and conversely, any decrease may be deducted from the profits brought out in the accounts as originally framed.

Notes on 5.—This head practically covers the ordinary business expenses. No voluntary donations or subscriptions are regarded as proper business outlays, they are held to be payments out of profits rather than charges against the profits. The general rule for dealing with items debited in the Profit and Loss Account is that the expenses allowed are those necessarily incurred in earning the trade profit, and must not cover a contingent loss under any head.

Deductions Disallowed.

The following are the most important of the items specified as not allowed in computing trade profits for purposes of Income Tax assessment:—

1. Interest on Capital, or Annual Interest, Annuity, or other annual payment made out of profits.
2. Partners' Salaries.
3. Improvements to or Depreciation of Buildings.
4. Any loss not connected with trade.
5. Income Tax paid.
6. Depreciation of Machinery and Plant.

Notes on 1 *and* 2.—Partners' Interest and Salaries both belong to one class in respect that they are appropriations of profit earned rather than charges incurred in earning the profit. What has to be ascertained is the trade profit, irrespective of how it is to be allocated among parties interested in it. These items give effect to stipulations which the partners made for regulating the allocation of profit among themselves, but these stipulations do not affect the amount of profit earned. The items are accordingly disallowed as deductions, but they fall to be specially treated in the allocation of the burden of a firm's tax among the partners, which question we shall return to later. Payment of all Annual Interest on borrowed money, Annuities, and other stated payments should be made under deduction of tax. The trader or firm making the Return must therefore be assessed on the whole profits earned, and recover by way of deduction from the receivers of these sums the tax on their several items. Interest on Bank overdraft is not annual interest, it is payable without deduction of tax, and it is therefore allowed as a charge against the trade profit.

Notes on 3.—Improvements to Buildings go to increase their capital value, and the cost of such improvements cannot therefore form a proper business expense. Depreciation on Buildings is covered by the allowance of one-sixth from the gross rent in ascertaining the Annual Value assessable under Schedule A, and no further claim can be allowed by way of a charge in the business Profit and Loss Account.

Notes on 4.—The Return is to be of the trade profits as adjusted for Income Tax assessment; no income or expenditure

outside of the business can be admitted to affect the trade profits, *e.g.* loss through speculation in securities.

Notes on 5.—When Income Tax, under either Schedule A or D, has been debited in the business Profit and Loss Account, it must be disallowed and written back. The tax is a levy on the income in the hands of the receiver, and is payable out of that income. Income Tax should not be debited in the Profit and Loss Account of any class of business; in a sole trader's concern it is a debit in his own account, like drawings; in a partnership the burden must be allocated, as will be demonstrated later, and the apportioned sums debited to the partners' current accounts; in a Company's books the net charge, if any, on the company, after crediting all recoveries by deduction, falls into the debit of the Appropriation Account.

Notes on 6.—The Depreciation on Machinery and Plant which has been written off in the accounts for the three years being brought into average has to be written back into profits, not because the nature of the charge is disallowed, but because the amount of it requires adjustment. The three years' profits should be averaged exclusive of any charge for depreciation, and when the average has been struck a deduction therefrom may be claimed in respect of the depreciation to be sustained in the course of the year of assessment. It should be noted that the claim for depreciation is to be based upon the value of the assets which are being exposed to deterioration in the assessment year. In other words, the claim is ordinarily at a percentage on the figure at which the plant stood in the Balance Sheet last preceding the commencement of the assessment year. It is provided in the Finance Act of 1907 that if there be no profits in any year from which the depreciation allowance or any part of it can be deducted, that allowance, or such part of it, may be carried forward to form an additional claim against the assessable profits of the succeeding year.

Adjusting the Accounts.

In adjusting the accounts for each of the three years to be averaged, all disallowed items which have been charged must be added back to the profits, and legitimate charges not made in the original accounts should be deducted. Particular care is necessary when the trader owns his business premises—probably no rent has been charged in the accounts, and as the net rent or annual value has been assessed under Schedule A, a charge must be made to avoid a double assessment. The feu-duty and mortgage interest must be disallowed, the owner's rates and landlord's repairs may be left as charges, and then the further charge in respect of the annual value already assessed under Schedule A should be made.

Further, if any trade investments are held and income is received from these, whether less tax or free of tax, such income should be deducted from the trade profit before averaging, as it has been already assessed.

For assessment purposes the firm's accounts may be recast, eliminating all disallowed items and including proper charges not originally made, or, preferably, a statement may be prepared from the original accounts showing the adjustments made to bring out the assessable profit. Example—

EXAMPLE of ADJUSTMENT of ACCOUNTS for Assessment.

	1st Year.	2nd Year.	3rd Year.
Net Profit per Accounts . . .	£700	£750	£620
Deduct—Dividends on Investments, already taxed .	30	30	30
	£670	£720	£590
Add—the following items charged in Accounts, disallowed—			
Partners' Salaries .	300	300	300
Interest on Capital .	260	270	265
Interest on Borrowed Capital (net) . .	95	95	95
Mortgage Interest (Net) . . .	95	95	95
Feu-duty (Net) . .	54	54	54
Loss on Shares realised	—	33	—
Income Tax paid (Sch. A) . .	27	27	27
Depreciation on Plant	209	216	219
Donation to (Charity) Fund . . .	—	—	25
Carry forward . .	£1710	£1810	£1670

	1st Year.	2nd Year.	3rd Year.
Brought forward .	£1710	£1810	£1670
Deduct—Annual Value of Premises .	537	537	537
	£1173	£1273	£1133
Adjust—Bad Debt Reserve and Discounts Provisions . . .	+9	-21	+18
Assessable Profits .	£1182	£1252	£1151
3 Years' Average Profits . .		£1195	
The Machinery and Plant stands in the last Balance Sheet at £2400 as its written-down value, and $7\frac{1}{2}$ per cent. is granted over all, giving a Depreciation Claim of		180	
Making the Net Assessable figure under Schedule D . . .		£1015	

The Finance Act of 1907 introduced a radical change in Income Tax law by the introduction of differentiation between earned and unearned incomes. Earned incomes are those derived from trade, employment, or vocation, and are assessable at a lower rate of tax; unearned incomes are those derived from property, and are assessable at a higher rate. The relief so granted to earned incomes must be claimed by the tax-payer filling up in his Return that Schedule and Declaration which gives his whole income whether taxed by deduction or not; this Schedule enables the Assessor to see that the Claimant's whole income is within the £2000 limit to which the relief is restricted. Formerly, partners in a firm could claim to be separately assessed with the view of claiming such abatements as they were severally entitled to, but now a firm is assessed as such, and the tax levied has afterwards to be apportioned between the partners. When any or all of the partners of a firm claim the benefit of the earned-income relief, those so claiming must still make an independent Return in addition to their firm's Return. We shall demonstrate by example, assuming the earned rate of tax to

Earned Income Relief.

Partnership.

be 9d. per £, and the unearned rate 1s. per £:—Suppose that the foregoing adjusted Statement of Assessable Profits were of the firm of A & B, of which firm A and B were the sole partners; that, after allowing Salaries of £200 to A and £100 to B, and 5 per cent. Interest on Capital, they shared profits equally; that A owned his dwelling-house of the Annual Value of £50; that B held private investments yielding £40 per annum gross; and, finally, that A paid £60 and B £40 in life insurance premiums on their own lives.

Firm's Return.

The firm's Return should be prepared first by averaging the profits after adjustment on the lines of the preceding Statement. The resulting figure of £1195 and also the Depreciation claim and the net assessable average of £1015 should be filled in on page 2 of the form, the £1015 being the sum to be directly assessed. Then on page 4 are to be entered the sums included in that £1015 which are payable to other parties under deduction of tax at the unearned rate. The only such item, other than property burdens, is Interest on Borrowed Capital, £100.

Out of the assessable average profit of . .			£1015
there is thus payable to an outsider in interest .			100
Showing divisible among partners . .			£915
Divisible for Assessment Year—	A	B	
Salary	£200	£100	
Interest on Capital (estimated, being 5 per cent. on Capital per last Balance Sheet, minus interest for a half-year on average drawings), say . .	146	125	
Balance divisible equally .	172	172	
	£518	£397	= £915

These totals for the partners should also be shown on page 4 of the form. The £1015 is now shown to consist of £915 earned profit and £100 unearned, all assessable on the firm, but to

entitle the partners to the earned rate on the £915 they must prepare their individual Returns. Their respective incomes from the firm of A & B are taken at the figures brought out above for the firm's Returns. A's Return on page 3 should show—

Partners' Returns.

Income from firm of A & B . .			£518
Annual Value of Dwelling-house .			50
Pro indiviso share of Works, etc., occupied by A & B—			
Annual Value		£537	
Less—Mortgage Interest	£100		
Feu-duty . . .	57		
		157	
		£380	
Whereof one-half			190
Income from Dividends on Investments held by A & B, £32—			
Whereof one-half (received less tax) .			16
			£774
Deductions—			
Feu-duty on Dwelling-house . . .		£10	
Interest on Mortgage on Dwelling-house		15	
		—	25
Total Income after Deductions . .			£749

Life Insurance Abatement Claim, £60.

B's Return on page 3 should show—

Income from firm of A & B			£397
Pro indiviso share of Works, etc., occupied by A & B—			
Annual Value		£537	
Less—Mortgage Interest .	£100		
Feu-duty . . .	57		
		157	
		£380	
Carry forward .			£397

Brought forward . . .	£397
Whereof one-half	190
Income from Investments (received less tax) .	40
Income from Investments held by A & B, £32;	
Whereof one-half	16
	£643
Deductions—	
None	—
Total Income after Deductions . . .	£643

Life Insurance Abatement Claim £40.

The firm is then assessed for Property Tax (Sch. A), on £537, of which it recovers by deduction on £157, showing a net assessment under this Schedule on £380, of which A and B bear one-half each, as shown in their separate Returns. The firm is assessed under Schedule D in these terms—

Assessment.

				Tax. at 1s.	Tax. at 9d.
Gross Assessment .			£1195		
Depreciation	General Abatem'ts	Ins'ce Abatem'ts			
180	70	100	350		
			—— Net £845		
			{100 at 1s. / 745 at 9d.}	£5 0 0	£27 18 9
				£32 18 9	

Allocation of Tax.

The firm thus pays Income Tax under	
Schedule A on £537 at 1s. . .	£26 17 0
and under Schedule D of . . .	32 18 9
A total burden of . .	£59 15 9

The most satisfactory method of allocation is to open an account for the tax, which would appear thus for the illustration—

Income Tax Account.

To Cash, Schedule A . . .	£26 17 0	By Tax recovered by deduction—	
,, ,, Schedule D . . .	32 18 9	On Interest on Capital	£5 0 0
,, Dividend Account, tax deducted	2 0 0	,, Mortgage Interest .	5 0 0
		,, Feu-duty . . .	2 17 0
		,, A, his proportion— On Profits . £518; less Ins. Ab. . 60; £458 at 9d.	17 3 6
		On Property, £190 at 1s.= £9, 10s.+£1 on Divs. .	10 10 0
		,, B, his proportion— On Profits . £397; less, Gen. Ab. £70, Ins. Ab. 40 — 110; £287 at 9d.	10 15 3
		On Property, £190 at 1s.= £9, 10s.+£1 on Divs. .	10 10 0
	£61 15 9		£61 15 9

The allocation of the Abatements to the partners entitled to them should be noted. We shall now examine A's Return as an example of how the assessment on a partner's total income is levied.

	Earned.	Unearned.
Proportion of Firm's Assessment under Schedule D . . .	£518 0 0	
Less Insurance Abatement .	60 0 0	
Net . .	£458 0 0	
Annual Value of Dwelling-house assessed directly under Schedule A		£50 0 0
Less Feu-duty £10, and Mortgage Interest £15 on Dwelling-house, recovered by deduction . .		25 0 0
Net . .		£25 0 0
One-half Net Annual Value of Firm's Works, etc., charged through firm's Schedule A assessment.		190 0 0
Carry forward . .		£215 0 0

	Earned.	Unearned.
Brought forward .		£215 0 0
One-half Dividends on Firm's Investments, taxed by deduction before receipt . . .		16 0 0
	£458 0 0	£231 0 0
	£689	
Being Amount of Income per Return £749 less Insurance Abatement £60	£689	

A development of the differentiation of earned from unearned incomes is to allow interest on borrowed capital to be set against the free balance of Annual Value, both of which items are chargeable at the higher rate, with the effect of reducing the amount chargeable at the higher rate and correspondingly increasing the amount chargeable at the lower rate in the direct assessment under Schedule D. *E.g.*, the £100 of interest on borrowed capital is, in the foregoing example, set against the adjusted average profit of £1015, showing £915 falling to the partners as earned income. But the free Annual Value of the premises is £380 on which the firm is chargeable in the £537 assessed under Schedule A, and the tax on this £100 may now be set against this £388, leaving £280 to bear the higher rate, and the £1195, less abatements of £350, net £845, would then be wholly chargeable at the lower rate, instead of £100 at the higher rate and £745 at the lower.

Tax on Companies.

Joint Stock Companies, in common with other corporate bodies, are assessed on the profits derived by them from the conduct of their business, and it must be noted that such assessment is not on the company as such, but on the income accruing to the members in the company's hands, that is, the company's earnings are the members' earnings and the assessment of the company is but one more illustration of taxation of the income at its source. It follows that a company is not entitled to the abatements claimable by individuals. The company is assessable at the

unearned rate of tax on the whole profits averaged in the ordinary way, and may then retain by deduction the tax on each member's share of profit represented by the dividends paid to him. The company should have in its books an Income Tax Account, to which would be debited the tax deducted from any of its revenues and also the tax paid by it under direct assessment under Schedule A on its own heritable property, under Schedule D on its profits, and under Schedule E on the Directors' Fees and Officials' Salaries if these are payable free of tax, as they occasionally are. This account would be credited with all tax recovered by the company by way of deduction, such as on feu-duty, interest on borrowed money, and debenture interest. If the dividends are declared "free of income tax," it means that they are payable without deduction of tax, that is, that in addition to appropriating the amount required to meet the dividend a further amount is appropriated to meet the tax on that dividend. Obviously the amount of such tax would be a debit in the Appropriation Account and a credit in Income Tax Account. If the dividends are payable "less tax," the gross dividend falls to be debited to Appropriation Account, the net dividend credited to Dividend Account, and the tax recovered by deduction credited to Income Tax Account. The Income Tax Account is thus debited with the tax paid by the Company, directly and by deduction; and is credited with the tax recovered by deduction or appropriated to relieve dividends. The Company is assessable on its whole profits properly estimated for Income Tax purposes, whereas it never declares as dividend the whole of such profits. Accordingly (apart from variations consequent upon the assessment being levied on an average instead of on the actual year's profits) the Dr. side of the Income Tax Account always exceeds the Cr. side, and the balance is transferred to the Dr. of Appropriation Account. This balance should approximately represent the tax on the undivided portion of the year's profits plus the excess or minus the shortage of the assessed average as compared with the year's actual profits.

The adjustment of a Company's profits for assessment is carried out in the same way as that of a firm, which we have already dealt with. One item requiring adjustment which

appears in a new Company's accounts but not in a firm's accounts is the periodical instalment written off Preliminary Expenses. This is a capital item, and cannot be allowed as a charge on profits; it must accordingly be written back to profits in the adjusting Statement.

INDEX

PRINTED BY WILLIAM GREEN AND SONS, EDINBURGH

END OF
TITLE